

CHAPTER-9

QUESTION-10

Following is the draft balance sheet of XYZ Limited as at 31 December 2014 which was prepared by its accountant:

	Rs. in million	Equities and liabilities	Rs. in million
Assets	250	Capital	
Leasehold land – cost	(200)	Accumulated profit	1,000
Leasehold land - acc amortization	1,000	Long term bank loan	1,816
Building – cost	(500)	Trade payables	200
Building - acc dep	1,750	Income tax payable	228
Machinery – cost	(1,150)	Accrued interest	85
Machinery - acc dep	70		13
Long term deposit	910		
Stocks	361		
Account receivables - net of provision	851		
Cash and bank	3,342		3,342

Additional information:

- (i) Profit before tax and income tax expenses for the year amounted to Rs.275 million and Rs.13 million respectively.
- (ii) Balances as at 31 December 2013 were as under:

	Rs. in million
Stock	703
Account receivables - net of provision	418
Cash and bank	213
Trade payables	150
Income tax payable	80
Long term deposit	70

The company follows a policy of maintaining provision for bad debts equal to 5% of account receivables.

- (iii) The bank loan was obtained on 1 January 2014 and carries interest @ 9% per annum.
- (iv) XYZ uses straight line method for depreciation. Rates of depreciation are as under:

Leasehold land	2%
Building	5%
Machinery	10%

Full month's depreciation is provided in the month of acquisition but no depreciation is charged in the month of disposal. Depreciation for the year 2014 has already been provided.

Required:

Prepare a statement of cash flow as at 31 December 2014.

(13)

{Spring-15, Q.4 CAF-05}

QUESTION-11

Following are the extracts from income statement of Quality Enterprises (QE) for the year ended 31 December 2015 and its statement of financial position as at that date, together with some additional information:

Income statement for the year ended 31 December 2015

	Rs. in '000
Profit from operations	6,402
Other income	1,357
Interest expense	(100)
Profit before tax	7,659
Income tax expense	(1,376)
Profit for the year	6,283

Statement-of financial position as at 31 December 2013

Statement of financial position as at 31 December 2013						
Equity and liabilities		2015	2014	Assets		
		---Rs. in '000---				
Owner's capital	14,219	10,703	Non-Current assets			
Unappropriated profit	10,652	6,697	Property, plant and equipment			
Revaluation surplus	2,676	1,911	Investments			
10% bank loan	6,000	-				
Current liabilities						
Trade and other payables	3,337	4,953	Current assets			
Income tax payable	1,300	994	Inventories			
Bank overdraft	-	27	Trade and other receivables			
	4,637	5,974	Cash and bank			
	38,184	25,285				
Additional information:						

Additional information:

- (i) During the year, movements in property, plant and equipment include:
- Depreciation amounting to Rs.5,280,000.
 - Machinery having a carrying amount of Rs.2,481,000 was sold for Rs.3,440,000.
 - Factory building was revalued from a carrying amount of Rs.5,963,000 to Rs. 8,000,000.
 - An office building which had previously been revalued, was sold at its carrying amount of Rs.2,599,000.
- (ii) The owner of QE withdrew Rs.300,000 per month. The amounts were debited to unappropriated profit.
- (iii) Trade debts written off during the year amounted to Rs. 200,000. The provision for bad debts as at 31 December 2015 was Rs. 400,000 (2014: Rs. 550,000)
- (iv) The interest on bank loan is payable on 30 June every year. The bank loan was received on 1 November 2015. Interest for two months has been accrued and included in trade and other payables.
- (v) Other income includes investment income of Rs. 398,000. As at 31 December 2015 trade and other receivables included investment income receivable amounting to Rs.96,000 (2014: Rs.80,000).

Required:

Prepare a statement of cash flows for Quality Enterprises for the year ended 31 December 2015, using the indirect method.

QUESTION-12

(18)
{Autumn-15 Q.5 CAF-05}

The statement of financial position of Liaquat Industries as at 31 December 2016 is as follows:

Equity and liabilities	2016	2015	Assets	2016	2015
	Rs.	Rs.		Rs.	Rs.
Owner's capital	13,938,060	13,665,280	Freehold land	4,778,400	6,600,000
Long-term loan	1,000,000	1,000,000	Building - WDV	5,057,600	4,171,200
Short term loan	1,331,200	1,531,200	Vehicle - WDV	600,000	800,000
Accounts payable	417,120	694,320	Equipment - WDV	1,643,100	2,112,000
Accrued interest	105,600	63,360	Capital work in progress	1,478,400	1,821,600
			Long-term deposits	580,800	448,800
			Inventory	685,608	320,628
			Accounts receivable	1,273,272	595,452
			Cash	694,800	84,480
	16,791,980	16,954,160		16,791,980	16,954,160

The following information has been extracted from income statement

Depreciation expenses
Finance cost
Gain on sale of fixed assets (net)
Net profit before tax

Rs
932,500
141,872
98,960
<u>1,525,948</u>

Additional information:

- (i) Details of gain on sale of fixed assets are as follows:

Gain on sale of freehold land
Loss on disposal of equipment due to fire

Rs.
168,960
(70,000)
<u>98,960</u>

The loss on disposal of equipment represents the WDV of the equipment. The amount of insurance claim received, amounting to Rs. 30,000 was erroneously credited to accumulated depreciation.

- (ii) Repairs to building amounting to Rs. 50,000 were erroneously debited to building account on 31 December 2016.
- (iii) Transfers from capital work in progress to building amounted to Rs. 1,200,000.
- (iv) The owner withdrew Rs. 150,000 per month.

Required:

Prepare statement of cash flows for the year ended 31 December 2016, in accordance with IAS – 7 using indirect method.

{Spring-17, Q.6 CAF-05}

QUESTION-13

Following information pertains to Nadir Limited:

Extract from statement of profit or loss for the year ended 31 December 2017

	Rs. in '000
Profit before taxation	8,955
Taxation	(2,945)
Profit after taxation	6,010

Extract from statement of financial position as on 31 December 2017

Equity and liabilities	2017	2016	Assets	2017	2016
	---- Rs. in '000 ----			---- Rs. in '000 ----	
Share capital	12,400	10,000	Property plant &		
Share premium	1,400	-	equipment – net	21,400	15,800
Retained earnings	13,450	12,440	Current assets:		
Surplus on revaluation	4,000	-	Stock-in-trade	5,600	5,750
Non-current liabilities:			Trade receivables – net	6,840	4,446
Long-term loans	4,100	5,000	Other receivables	2,385	800
Current liabilities:			Cash & bank	2,355	3,204
Trade payables	1,900	1,400			
Accruals & other payables	680	660			
Tax liability	650	500			
	38,580	30,000		38,580	30,000

Other information:

- (i) Shares issued during the year were as follows:
- 10% bonus shares in March 2017.
 - Right shares in July 2017.

- (ii) During the year, a plant costing Rs. 9,500,000 and having a book value of Rs. 5,200,000 was disposed of for Rs. 4,800,000 of which Rs. 1,800,000 are still outstanding.
- (iii) Depreciation for the year amounted to Rs. 7,350,000.
- (iv) Financial charges for the year amounted to Rs. 1,100,000. Accrued financial charges as on 31 December 2017 amounted to Rs. 112,000 (2016: Rs. 48,000).
- (v) Provision for doubtful trade receivables is maintained at 5%.

Required:

Prepare statement of cash flows for the year ended 31 December 2017, in accordance with IAS 7 'Statement of Cash Flows' using indirect method.

(15)

{Spring-18, Q.3}

QUESTION-14

Junior Accountant of Drum Limited has prepared the following statement of cash flows for the year ended 31 December 2018:

Statement of cash flows	
Cash flows from operating activities	
Increase in retained earnings	Rs. in '000'
Increase in dividend payable	1,360
Increase in net trade receivables	200
Increase in interest accrued	(100)
	50
	<hr/> 1,510
Cash flows from investing activities	
Increase in land and building	
Increase in equipment	(2,600)
Decrease in inventory	(1,550)
Decrease in tax payable	400
	(60)
	<hr/> (3,810)
Cash flows from financing activities	
Increase in share capital and premium	
Decrease in long term loan	2,350
Increase in trade and other payables	(1,000)
	600
	<hr/> 1,950
Decrease in cash balance during the year	(350)
Opening cash balance	450
Closing cash balance	<hr/> 100

Junior Accountant informed you that he has taken the difference of opening and closing balances of each balance sheet item and classified each difference as either operating, investing or financing cash flows. He further informed that the statement is tied up with the cash balances appearing in the balance sheet. He has ignored the following information:

- (i) Depreciation on building and equipment amounted to Rs. 480,000 and Rs. 810,000 respectively.
- (ii) During the year, an equipment costing Rs. 560,000 and having a book value of Rs. 310,000 was sold for Rs. 440,000.
- (iii) Provision for doubtful debts was increased by Rs. 140,000.
- (iv) Dividend amounting to Rs. 700,000 was paid during the year.
- (v) Interest and tax expenses for the year amounted to Rs. 378,000 and Rs. 650,000 respectively.
- (vi) Trade and other payables as at 31 December 2018 included Rs. 950,000 for purchase of land and building.

Required:

Prepare statement of cash flows for the year ended 31 December 2018, in accordance with IAS 7 'Statement of Cash Flows' using indirect method.

(14)

{Spring-19, Q.7}

QUESTION-15

Following are the extracts from the financial statements of Sunday Traders Limited (STL) for the year ended 30 June 2019:

Statement of financial position as on 30 June 2019

Statement of financial position as at 31.12.2018					
Assets	2019	2018	Equity & Liabilities	2019	2018
	Rs. in million			Rs. in million	
Property, plant and equipment	8,555	7,240	Share capital (Rs.100 each)	4,650	3,450
Investment property	1,800	1,120	Share premium	1,600	1,240
Stock in trade	4,800	4,500	Retained earnings	1,652	(655)
Prepayments	184	268	Long term loans	6,024	6,523
Trade receivables	3,800	3,600	Trade payables	3,422	5,390
Cash	194	480	Contract liability	250	40
			Accrued liabilities	310	180
			Interest payable	135	110
			Current maturity of long y term loans	850	700
			Provision for taxation	440	230
	19,333	17,208		19,333	17,208

Statement of profit or loss for the year ended 30 June 2019

	Rs. in million
Sales	29,700
Cost of sales	(15,750)
Gross profit	13,950
Distribution cost	(6,185)
Administrative cost	(2,302)
Other income	404
Profit before interest and tax	5,867
Interest expense	(1,210)
Profit before tax	4,657
Tax expense	(1,150)
Profit after tax	3,507

Additional information:

- (i) 72% of sales were made on credit.
- (ii) Depreciation expense for the year amounted to Rs.750 million which was charged to distribution and administrative cost in the ratio of 3:1.
- (iii) Distribution cost includes:
 - Rs.40 million in respect of loss on disposal of equipment. The written down value at the time of disposal was Rs.152 million.
 - impairment loss on vehicles amounting to Rs.24 million.
- (iv) Loan instalments (including interest) of Rs.1,984 million were paid during the year.
- (v) Other income comprises of:
 - increase in fair value of investment property amounting to Rs.220 million.
 - rent received from investment property amounting to Rs.184 million.
- (vi) During the year, STL issued right shares at premium.

Required:

Prepare STL's statement of cash flows for the year ended 30 June 2019 using direct method.

(19)

{Autumn -19, Q.5}

QUESTION-16

You are working as Finance Manager in Broad Peak Limited (BPL). Faraz has recently joined BPL as an internee for three months. You have asked him to develop an understanding of the statement of cash flows. After going through few statements, he has raised the following queries:

- Depreciation is not a cash flow but was still appearing as an addition in the statement of cash flows.
- In the statement of cash flows of a competitor, interest paid was shown as a financing activity but BPL showed it in operating activities.
- BPL purchased inventories throughout the year but total purchases of inventory were not shown in the statement. However, only decrease in inventory was added.
- Cash and bank balance in the statement of financial position was not in agreement with the opening and closing balances at the end of statement of cash flows.

Required:

Briefly answer the queries raised by Faraz.

(08)

(Spring 2020 Q.2)

QUESTION-17

Statement of financial position of Taxila Limited (TL) as on 30 June 2020 is as follows:

Assets	2020	2019	Equity & liabilities	2020	2019
	Rs. in million			Rs. in million	
Property, plant and equipment	1,619	1,200	Share capital (Rs.100 each)	1,200	800
Investment property	290	120	Share premium	290	150
Inventories	205	180	Retained earnings	260	90
Trade receivables	342	291	Revaluation surplus	215	200
Prepayments and other receivables	14	20	Long-term loans	367	445
Short-term investments	60	48	Trade and other payables	144	120
Cash and bank balances	24	6	Current portion of long-term loans	78	60
	2,554	1,865		2,554	1,865

Additional information:

- Equipment having fair value of Rs.240 million was acquired by issuing 2 million shares.
- As a result of revaluation carried out on 30 June 2020, property, plant and equipment was increased by Rs.80 million out of which Rs.35 million was credited to profit and loss account.
- During the year, fully depreciated items of property, plant and equipment costing Rs.36 million were sold for Rs.8 million out of which Rs.3 million is still outstanding.
- Depreciation on property, plant and equipment for the year amounted to Rs.290 million.
- An investment property was acquired for Rs.180 million. TL applies cost model for subsequent measurement of its investment property.
- Financial charges for the year amounted to Rs.45 million. Trade and other payables include accrued financial charges of Rs.12 million (2019: Rs. 17 million).
- Short-term investments amounting to Rs.35 million are readily convertible to cash (2019: Rs.20 million). Investment income for the year amounted to Rs.6 million.

Required:

Prepare TL's statement of cash flows for the year ended 30 June 2020 in accordance with the requirements of IFRSs.

(17)

(Autumn 2020 Q 6)

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QUESTION-18

Following are the extracts from the financial statements of Saguaro Limited (SL) for the year ended 30 June 2021:

Following are the extracts from the financial statements for the year ended 30 June 2021:

Statement of financial position as on 30 June 2021					
Assets	2021	2020	Equity & liabilities	2021	2020
	Rs. in million			Rs. in million	
Operating fixed assets	820	848	Share capital (Rs. 10 each)	700	500
Accumulated depreciation	(300)	(262)	Share discount	(40)	-
Capital work in progress	84	-	Retained earnings	220	315
Inventories	274	245	Long-term loans	175	210
Trade receivables	177	204	Trade payables	180	130
Insurance claim	-	31	Accrued expenses	48	43
Advance to supplier	78	60	Current portion of long-term loans	43	40
Cash and bank balances	1931	112			
	1,326	1,238		1,326	1,238

the year ended 30 June 2021

Statement of profit or loss for the year ended 30 June 2021

	Rs. in million
Sales	757
Cost of sales	(485)
Gross profit	272
Operating expenses	(310)
Gain on disposal of equipment	17
Loss before interest	(21)

Other information:

- SL declared a final dividend of 10% on 30 September 2020 which was paid in December 2020.
- 20 million shares were issued in May 2021.
- Insurance claim was related to plant and machinery destroyed in April 2020. The plant had cost and book value of Rs. 63 million and Rs. 42 million respectively.
- During the year, SL disposed of equipment having cost and net book value of Rs. 75 million and Rs. 35 million respectively.
- Current portion of long-term loans include accrued interest of Rs. 5 million. (2020: Rs. 1 million)
- Trade payables include an amount of Rs. 14 million payable against capital work in progress.

Required:

Prepare SL's statement of cash flows for the year ended 30 June 2021.

(16)
(Autumn 2021 Q6)

ICAP PAST PAPER SOLUTIONS**Answer-1**

Mr. Fazal Din
Statement of Cash flow
for the year ended December 31, 2006

Cash flow from Operating Activities

Profit for the year

Adjustments for:

Depreciation

Profit on sale of equipment

(W-2)

(W-4)

(W-5)

Rs.

275,000

160,000

(20,000)

140,000

415,000

Operating cash flow before working capital changes

Adjustment for working capital changes

(increase)/decrease in current assets

(increase)/decrease in inventory

(increase)/decrease in debtors

(increase)/decrease in prepayments

Increase/(Decrease) in current liabilities

Increase/(decrease) in creditors

increase/(decrease) in accrued expenses

Working capital changes

Net cash flow from operating activities

A

255,000

Cash flow from Investing Activities

Purchase of fixed assets

Sale proceeds from disposal of equipment

(W-3)

(600,000)

60,000

Net cash flow from investing activities B

Cash flow from Financing Activities

New capital from owner

Drawing

B

(540,000)

Net cash flow from financing activities

Net increase/(decrease) in cash and cash equivalents

Add: cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period

C

(A+B+C)

(W-1)

(W-1)

(100,000)

(100,000)

(385,000)

(100,000)

(485,000)

WORKINGS**(W-1) Cash and cash equivalents**

Cash in hand

Bank overdraft

2005

2006

200,000

300,000

(300,000)

(785,000)

(100,000)

(485,000)

(W-2)

Dr.

Drawing

cl.

Capital account

100,000

1,575,000

1,675,000

op.

Profit (bal.)

Cr.

1,400,000

275,000

1,675,000

(W-3)		Fixed asset at cost		Cr.
Dr.				
op.		1,150,000	Asset disposal	100,000
Cash (additions) (bal.)		600,000	cl.	1,650,000
		<u>1,750,000</u>		<u>1,750,000</u>

No separate balances of fixed assets are given, therefore additions of Rs. 350,000 are included in the figure of Rs. 600,000 which is calculated as balancing figure.

(W-4)		Allowance for depreciation		Cr.
Dr.				
Asset disposal (W-5)		60,000	op.	75,000
cl.		<u>175,000</u>	Depreciation (bal.)	160,000
		235,000		<u>235,000</u>

(W-5)		Equipment Disposal Account		Cr.
Dr.				
Cost		100,000	Dep. (Cost - WDV) (100,000-40,000)	60,000
P and L (bal.)		<u>20,000</u>	Cash	60,000
		120,000		<u>120,000</u>

Answer-2

Mr. Moosani
Cash flow statement.

for the year ended December 31, 2008

Cash flow from Operating Activities

		Rs.
Profit for the year	(W-1)	220,200
Adjustments for:		
Depreciation		
-Furniture	(W-4)	8,000
-Equipment	(W-5)	15,200
Gain on sale of furniture	(W-6)	(11,000)
Loss on sale of equipment	(W-7)	7,300
Profit on sale of investments	(W-9)	(7,500)
		<u>12,000</u>
Operating cash flow before working capital changes		232,200
Adjustment for working capital changes		
(Increase/decrease in current assets		
(Increase)/decrease in inventory		(5,600)
(increase)/decrease in accounts receivable-net [(31,700-6,500) - (21,500-9,700)]		(13,400)
Increase/(Decrease) in current liabilities		
Increase/(decrease) in creditors		4,300
Increase/(decrease) in bills payable		(2,100)
Increase/(decrease) in accrued expenses		(6,500)
Working capital changes		<u>(23,300)</u>
Net cash flow from operating activities	A	208,900

Cash flow from Investing Activities

Purchase of fixed assets

-Furniture

-Equipment

Sale proceeds from disposal of fixed assets

-Furniture

-Equipment

Sale proceeds from disposal of investments

Net cash flow from investing activities

Cash flow from Financing Activities

New capital from owner

Loan repayment

Drawing

Net cash flow from financing activities

Net increase in cash and cash equivalents

Add: cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period

(W-2)

(W-3)

(W-9)

B

(W-8)

(W-8)

(15,000x12)

C

(A+B+C)

(80,000)

(66,000)

60,000

6,500

24,400

(55,100)

12,000

(22,000)

(180,000)

(190,000)

(36,200)

41,400

5,200

WORKINGS

(W-1)

Dr.

Capital account

Drawing (15,000x12)

cl.

180,000

136,000

316,000

op.

Profit (bal.)

Long term loan (new capital) (W-8)

Cr.

83,800

220,200

12,000

316,000

(W-2)

Dr.

op.

Cash (additions) (bal.)

Furniture at cost

64,000

80,000

144,000

Furniture disposal

cl.

Cr.

64,000

80,000

144,000

(W-3)

Dr.

op.

Cash (additions) (bal.)

Equipment at cost

43,000

6,000

109,000

Equipment disposal

cl.

Cr.

23,000

86,000

109,000

(W-4)

Dr.

Asset disposal

cl.

15,000

8,000

23,000

op.

Depreciation (bal.)

Cr.

15,000

8,000

23,000

(W-5)

Dr.

Asset disposal (W-7)

cl.

9,200

24,000

33,200

op.

Depreciation (bal.)

Cr.

18,000

15,200

33,200

(W-6)

Dr.

Cost

P and L (bal.)

Furniture Disposal Account

64,000

11,000

75,000

Accumulated depreciation

Cash (insurance company)

Cr.

15,000

60,000

75,000

CHAPTER-9

As whole of the opening furniture is destroyed, so the opening balance of asset account and accumulated depreciation account is transferred to disposal account.

(W-7)

Dr.

Cost

Equipment Disposal Account

23,000

Accumulated depreciation
(23,000x40%)

Cash

P and L (bal.)

23,000

Cr.

9,200

6,500

7,300

23,000

(W-8)

Dr.

Cash (22,000-12,000)

Capital

cl.

Long term loan

10,000

12,000

31,800

53,800

op.

Cr.

53,800

53,800

Entry for loan repayment

Long term Loan

Cash (bal.)

Capital

(Repayment of loan through business cash and through personal account)

Dr.

22,000

Cr.

10,000

12,000

(W-9) Entry for disposal of investment

Cash (bal.)

P and L

Investment

(Entry for disposal of investment)

Dr.

24,400

Cr.

7,500

16,900

Answer-3

Mr. Sakhawat Hussain

Statement of Cash flow

for the year ended December 31, 2009

Cash flow from Operating Activities

Profit

(W-2)

Rs.

1,400,000

Adjustments for:

Depreciation

(W-4)

1,500,000

Gain on sale of fixed assets

(W-6)

(90,000)

Profit on sale of investments

(W-8)

(70,000)

1,340,000

2,740,000

Operating cash flow before working capital changes

Adjustment for working capital changes

(Increase)/decrease in current assets excluding cash

Increase/(Decrease) in current liabilities

Working capital changes

(1,520,000)

450,000

(1,070,000)

1,670,000

Net cash from operating activities

A.

Cash flow from Investing Activities

Purchase of fixed assets	(W-3)	(1,310,000)
Sale proceeds from disposal of fixed assets		250,000
Investments purchased	(W-7)	(350,000)
Sale proceeds from disposal of investments		320,000
Net Cash from investing activities	B	(1,090,000)

Cash flow from Financing Activities

New Capital form owner	(W-1)	1,000,000
Drawing		(1,200,000)
Net cash from financing activities	C	(200,000)
Net increase in cash and cash equivalents (A+B+C)		380,000
Add: cash and cash equivalents at beginning of period		570,000
Cash and cash equivalents at end of period		950,000

Cash and cash equivalents

		2009	2008
Current assets	A	4,750,000	2,850,000
Percentage	B	20%	20%
Cash	C = A x B	950,000	570,000
Current assets excluding cash	D = A - C	3,800,000	2,280,000

WORKINGS

(W-1)

Dr.

Capital account

Cr.

cl.	11,000,000	Op.	10,000,000
(W-2)		Cash (bal.)	1,000,000

Dr.

Profit and loss account

Cr.

Drawings	1,200,000	Op.	900,000
cl.	1,100,000	Profit (bal.)	1,400,000
(W-3)			

Dr.

Fixed assets

Cr.

Op.	9,600,000	Disposal account [furniture (ii)]	200,000
Cash (additions) (bal.)	1,310,000	Disposal account [others-(iii)]	960,000
(W-4)		cl.	9,750,000

Dr.

Accumulated depreciation

Cr.

Disposal (ii)	200,000	Op.	2,450,000
Disposal (iii) (960,000-160,000)	800,000	Depreciation (bal.)	1,500,000
(W-5)			

Dr.

Disposal account

Cr.

Cost	200,000	Accumulated depreciation	200,000
(W-6)		Cash	-

Dr.

Disposal account

Cr.

Cost	960,000	Accumulated depreciation	800,000
P and L (bal.)	90,000	Cash	250,000
(W-7)			

Dr.

Investments

Cr.

Op.	2,500,000	Disposal	250,000
Cash (additions) (bal.)	350,000	cl.	2,600,000

(W-8)

Entry for disposal of investment

Cash (bal.)

P and L

Investment

(bal.)

Dr.
320,000

Cr.

70,000
250,000**Answer-4**

Mr. Junaid Janjua
Cash flow Statement
for the year ended December 31, 2010

Cash flow from Operating Activities

Profit for the year

(W-2)

Adjustments for:

Depreciation

(Gain) on sale of land

(Gain)/loss on sale of long term investments

Loss on sale of equipment

Operating cash flow before working capital changes

Adjustment for working capital changes

(Increase)/decrease in current assets

(Increase)/decrease in inventory

(Increase)/decrease in debtors (gross)

(Increase)/decrease in prepayments

(Increase)/decrease in office supplies

Increase/(Decrease) in current liabilities

Increase/(decrease) in accounts payable

Increase/(decrease) in accrued expenses

Working capital changes

Cash generated from operations

Less:

Drawings made

Net Cash from operating activities

A

Cash flow from Investing Activities

Purchase of building

(W-5)

Purchase of equipment

(W-7)

Sale proceeds from disposal of land

(W-4)

Sale proceeds from disposal of equipment

(W-9)

Purchase of long term investment

(W-11)

Sale proceeds of investment

(W-12)

Net cash from investing activities

B

Cash flow from Financing Activities

New capital from owner

(W-2)

Loan repaid

(W-10) (100,000+75,000)

Net cash from financing activities

C

Net increase in cash and cash equivalents

(A+B+C)

Add: cash and cash equivalents at beginning of period

(W-1)

Cash and cash equivalents at end of period

(W-1)

Rs.

950,000

230,000

(64,000)

(32,000)

15,000

149,000

1,099,000

(224,000)

(176,000)

12,000

(7,000)

(105,000)

16,000

(484,000)

615,000

(568,000)

47,000

(500,000)

(155,000)

754,000

60,000

(150,000)

132,000

141,000

100,000

(175,000)

(75,000)

113,000

(548,000)

(435,000)

WORKINGS

(W-1) Cash and cash equivalents

Cash
Less: Short term loans

2010	2009
145,000	32,000
(580,000)	(580,000)
<u>(435,000)</u>	<u>(548,000)</u>

(W-2)

Dr.	Capital account	Cr.
Drawing	568,000	b/d
c/d	3,884,000	Profit (bal.)
	<u>4,452,000</u>	Loan a/c (New capital)
		<u>4,452,000</u>

(W-3)

Dr.	Land at cost	Cr.
b/d	2,500,000	Land disposal (bal.)
		c/d
		<u>1,810,000</u>

(W-4)

Dr.	Land Disposal Account	Cr.
Land cost (W-3)	690,000	Accumulated depreciation
P and L	64,000	Cash (bal.)
		<u>754,000</u>

(W-5)

Dr.	Building at Cost	Cr.
b/d	2,300,000	
Additional (bal.)	500,000	c/d
		<u>2,800,000</u>

(W-6)

Dr.	Accumulated depreciation-building	Cr.
c/d	890,000	b/d
		Depreciation (bal.)
		<u>170,000</u>

(W-7)

Dr.	Equipment at cost	Cr.
b/d	1,150,000	Disposal (W-9)
Additional (bal.)	155,000	c/d
		<u>1,200,000</u>

(W-8)

Dr.	Accumulated depreciation-equipment	Cr.
Disposals (bal.)	30,000	b/d
c/d	380,000	Depreciation
		<u>60,000</u>

(W-9)

Dr.	Equipment Disposal Account	Cr.
Cost [(W-8) (30,000 + 75,000)]	105,000	Accumulated depreciation
		P and L
		Cash (bal.)
		<u>60,000</u>

(W-10)

Dr.	Long term loan	Cr.
Cash (bal.)	75,000	b/d
Capital	100,000	
c/d	<u>985,000</u>	<u>1,160,000</u>

Entry for loan repayment

Long term Loan

Cash (bal.)

Capital

(Repayment of loan through business cash and through personal account)

Dr.	Cr.
175,000	
	75,000
	100,000

(W-11)

Dr.	Investment	Cr.
b/d	170,000	Disposed
Cash (new purchased) (bal.)	150,000	c/d
		100,000
		220,000

(W-12) Entry for disposal of investment

Cash (bal.)

P and L

Investment

(Entry for disposal of investment)

Dr.	Cr.
132,000	
	32,000
	100,000

Answer-5

Amin Industries
Cash flow Statement
for the year ended 31 August 2011

Cash flow from Operating Activities

Profit during the year

Adjustments for:

Depreciation

(W-6)

Gain on sale of fixed assets

(W-7)

Rs.
3,161,000

2,498,000

(417,000)

2,081,000

5,242,000

Operating cash flow before working capital changes

Adjustment for working capital changes

Debtors

(1,845,000)

Stock

(14,950,000-12,178,000)

2,772,000

Creditor

(3,457,000-2,850,000)

607,000

Working capital changes

1,534,000

Drawings

(3,120,000)

Net Cash from operating activities

A

3,656,000

Cash flow from Investing Activities

Sale proceeds from fixed assets

1,284,000

Purchase of fixed assets

(W-5)

(6,191,000)

Net cash from investing activities

B

(4,907,000)

Cash flow from Financing Activities

New capital from owner

(W-4)

5,450,000

Loan raised/ (repaid)

-

Net cash from financing activities

C

5,450,000

Net increase in cash and cash equivalents

(A+B+C)

4,199,000

Add: Cash and cash equivalents at beginning of period

(1,391,000)

Cash and cash equivalents at end of period

2,808,000

WORKINGS**(W-1) Cash and cash equivalents**

Short term investments
Short term finance
Bank

2011	2010
4,911,000	-
(2,545,000)	(1,616,000)
442,000	225,000
<u>2,808,000</u>	<u>(1,391,000)</u>

(W-2) Calculation of cost of fixed assets

Fixed asset-BV
Add: Accumulated Depreciation
Fixed assets-at cost

	2011	2010
Net	15,172,000	12,346,000
	7,470,000	5,605,000
Gross	<u>22,642,000</u>	<u>17,951,000</u>

(W-3) Calculation of gross debtors

Net Debtors
Add: Provision for bad debts
Gross Debtors

	2011	2010
Net	6,732,000	4,887,000
	484,000	385,000
Gross	<u>7,216,000</u>	<u>5,272,000</u>

(W-4) Dr.	Capital account	Cr.
Drawing	3,120,000	Op.
		Profit
cl.	33,433,000	New capital (bal.)

(W-5) Dr.	Fixed Assets-at cost	Cr.
b/d (W-2)	17,951,000	Disposal
Additions (bal.)	6,191,000	c/d (W-2)

(W-6) Dr.	Accumulated depreciation	Cr.
Disposal (1,500,000-867,000)	633,000	Op.
cl.	7,470,000	Depreciation (bal.)

(W-7) Dr.	Disposal Account	Cr.
Cost	1,500,000	Acc.dep. (1,500,000-867,000)
P and L (bal.)	417,000	Cash

(W-8) Dr.	Provision for bad debts account	Cr.
		op.
cl.	484,000	P and L (bal.)

Answer-6

Rehan Brothers
Cash flow statement
for the year ended June 30, 2007

Cash flow from Operating Activities		Rs.
Adjusted loss for the year	(W-1)	(503,000)
Adjustments for:		
Depreciation		163,000
Gain on disposal of plot of land	(W-2)	(210,000)
Loss on disposal of lather machine	(W-3)	54,000
Gain on exchange of computer	(W-5)	(5,000)
		<u>2,000</u>
Operating cash flow before working capital changes		(501,000)
Adjustment for working capital changes		
(increase)/decrease in current assets		(70,000)
increase/(Decrease) in current liabilities		90,000
Working capital changes		<u>20,000</u>
Net cash flow from operating activities	A	(481,000)

Cash flow from Investing Activities

Sale proceeds of plot of land
 Sale proceeds of lather machine
 Purchase of computer

Net cash flow from investing activities

B**Cash flow from Financing Activities**

New capital from owner
 Drawing

Net cash flow from financing activities

C

Net increase in cash and cash equivalents

(A+B+C)

Add: cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period

600,000
50,000
(50,000)
600,000

-
-
-
119,000
XXX
XXX

Rs.

(453,000)
(50,000)
(503,000)

WORKINGS**(W-1) Adjusted loss for the year**

Un-adjusted loss (as given)

Less: Repair expense wrongly debited to accumulated depreciation

(W-2)

Dr.		Land Disposal Account		Cr.
Cost	390,000	Accumulated depreciation		-
P and L (bal.)	210,000	Cash		600,000
	600,000			600,000

It has been assumed that plot of land has not been purchased in the current year, therefore Rs. 390,000 has not been shown in the investing activities.

(W-3)

Dr.		Lather machine Disposal Account		Cr.
Cost	200,000	Accumulated depreciation (W-3.1)		96,000
		Cash		50,000
		P and L (bal.)		54,000
	200,000			200,000

(W-3.1) Accumulated depreciation of lather machine

	Lather Machine
Cost	200,000
Residual value (20% of 200,000)	(40,000)
Depreciable amount	160,000
Depreciation per year (160,000 x 10%)	16,000
Life until the date of disposal (in years)	6 years
Accumulated depreciation (16,000 x 6)	96,000

(W-4)

Dr.		Office equipment disposal account		Cr.
Cost	5,600	Accumulated depreciation		5,600
		Cash		-
		P and L (bal.)		-
	5,600			5,600

As the equipment is written off so nothing is received on its disposal.

(W-5) Entry for exchange of computer

	Dr.	Cr.
Machinery- at cost (new)	65,000	
Accumulated depreciation (old computer) (30,000-10,000)	20,000	
P and L (bal.)		5,000
Computer- at cost (old)		30,000
Cash		50,000

Answer-7

It was a simple question and all the required information was readily available. The only figure which was required to be worked out was additions to the non-current assets. For calculating the additions to the non-current assets firstly the furniture disposal account was required to be prepared to calculate the WDV of assets disposed off. By putting this figure in the assets account, the additions are calculated as balancing figure. Further the final answer of this question cannot be checked because opening and closing balances of cash and cash equivalents are not given in the question.

Cash flow Statement
For the year ended June 30, 2008

	Rs.
Cash flow from operating activities:	
Profit for the year	256,800
Adjustments for:	
Depreciation	17,500
Loss on disposal of furniture	6,800
Operating cash flow before working capital changes	281,100
Increase in debtors	(11,700)
Decrease in stocks	21,600
Increase in creditors	8,900
Net cash flow from operating activities	299,900
Cash flow from investing activities:	
Purchase of non-current assets	(28,900)
Proceeds from sale of non-current assets	12,000
Net cash flow from investing activities	(16,900)
Cash flow from financing activities:	
Loan repaid	(75,000)
Withdrawals	(120,000)
Net cash flow from financing activities	(195,000)
Net increase/(decrease) in cash and cash equivalents during the year	88,000

WORKINGS

(W-1)

The opening and closing WDV of assets are not given in the question rather only decrease in assets amounting to Rs. 7,400 is given. It means if we suppose that opening assets have a book value 100,000 then closing assets would have a book value of 92,600 (i.e. a decrease of Rs 7,400).

Dr.	Furniture account at WDV	Cr.
b/d (assumed)	100,000	Disposal (W-1.1) 18,800
Additions (bal. fig.)	28,900	Depreciation 17,500
		c/d (assumed) 92,600
	128,900	128,900

The opening and closing book values are assumed to calculate the additions as a balancing figure. Instead of these figures you could have assumed any figures which had a difference of Rs. 7,400 say 150,000 as opening book value and 142,600 as closing book value. The result would be the same.

(W-1.1)

Furniture disposal account			
Dr.			Cr.
WDV (bal. fig.)	18,800	Cash	12,000
		P and L (loss)	6,800
	<u>18,800</u>		<u>18,800</u>

Answer-8**Cash flow from Operating Activities**

Profit before tax

Adjustments for:

Depreciation

Interest expense

Operating cash flow before working capital changes

Adjustment for working capital changes

(Increase)/decrease in current assets

(Increase)/decrease in stocks

(Increase)/decrease in debtors (gross)/ bill receivable

(Increase)/decrease in prepayments

Increase/(Decrease) in current liabilities

Increase/(decrease) in creditors/ bills payable

Increase/(decrease) in accrued expenses

Working capital changes

Less: Income tax paid

(W-1)

Net Cash from operating activities

Cash flow from Investing Activities**Cash flow from Financing Activities**

Net increase in cash and cash equivalents (A+B+C)

WORKINGS

(W-1)

Dr.

Tax expense			
Dr.			Cr.
Cash (bal.)	118,000	b/d	28,000
c/d	-		

Answer-9**Cash flow from Operating Activities**

Profit before tax

Adjustments for:

Depreciation

Financial Charges (interest expenses)

Loss on Car

Operating cash flow before working capital changes

Rs. in Million

(W-1)

(9 + 6.25)

13.2

15.25

2.5

0.35

18.10

Adjustment for working capital changes (increase)/decrease in current assets		
Account Receivables - net	[0-(18-0.9)]	(17.10)
Inventory		(10.00)
(increase)/decrease in current liabilities		14.00
Account Payable (Creditor)		(13.1)
Working capital changes		18.2
Cash generated from Operations		(1.3)
Less: Finance charges paid	(W-8)	(5.00)
Income Tax paid	(W-7)	(2.45)
Drawing	(W-5)	9.45
Net cash flow from operating activities	(A)	
Cash flow from Investing Activities		
Purchase of Property, Plant and Equipment	(W-2)	(103.65)
Proceed from insurance	(W-3)	1.2
Net cash from Investing Activities	(B)	(102.45)
Cash flow from Financial Activities		
Cash contributed by the Partner		50
Proceed from long term loan		25
Net cash flow from financing activities	(C)	75
Net increase in cash and cash equivalent	(A+B+C)	(18.00)
Add: Cash and cash equivalent at year start		0
Cash and cash equivalent at end of year	(W-6)	(18.00)

WORKINGS

(W-1) Profit before tax

Rs. in Million

Sales	136.00
Less: Cost of sales	(83.50)
Operating & Selling expenses	(37.30)
Add: Miscellaneous Income	0.50
Less: Finance charges	(2.50)
Profit before tax	13.2

(W-2)

Dr.	Property, Plant & Equipment Account	Cr.
Capital (building)	25	Disposal
Capital	1.4	
Cash & Bank (bal.)	103.65	c/d
		128.25

(W-3)

Dr.	Disposal Account	Cr.
Property, plant and equipment	1.8	Accumulated Depreciation
		P/L
		Cash (bal.)
		0.25
		0.35
		1.2

(W-4)

Dr.	Accumulated Depreciation Account	Cr.
Disposal	0.25	b/d
c/d	15	Depreciation Expense (9 + 6.25)
		15.25

(W-5)

Dr.	Partners' Capital	Cr.
Drawings (bal.)	2.45	Cash
		Building
c/d	73.95	Car
		50
		25
		1.4

CHAPTER-9

(W-6)

Cash and cash equivalent at end of yearCash and Bank
Bank Overdraft

5.00
(23.00)
(18.00)

(W-7)

Dr.	Taxation Expense	Cr.
Cash (bal.)	5.00 P/L	6.00
cl. payable	1.00	

(W-8)

Dr.	Interest Expense	Cr.
Cash (bal.)	1.30 P/L	2.50
cl. payable	1.20	

Answer-10

XYZ Limited
Statement of Cash Flow
For the year ended 31 December 2014

Rs. in Millions

Cash flow indirect methodCash flow from Operating Activities

Profit before tax		275
Adjustments for:		
Depreciation	(W-4)	230
Interest expense	(W-1)	18
Operating cash flow before working capital changes		523
Adjustment for working capital changes		
(Increase) /decrease in current assets		
(Increase)/ decrease in inventories	(703-910)	(207)
(Increase) /decrease in trade receivables	(418-361)	57
Increase/ (Decrease) in current liabilities		
Increase/ (decrease) in trade payables	(150-228)	78
Working capital changes		(72)
Cash generated from operations		451
Less:		
Interest paid	(W-1)	(5)
Income tax paid	(W-2)	(8)
Net Cash from operating activities	A	438

Cash flow from Investing Activities

Purchase of fixed assets		-
Net cash from investing activities	B	-

Cash flow from Financing Activities

Long term loan raised		200
Net cash from financial activities	C	200
Net increase in cash and cash equivalents (A+B+C)		638
Add: Cash and cash equivalents at beginning of period		213
Cash and cash equivalents at end of period		851

WORKINGS

(W-1)	Dr.	Interest Expense	Cr.
	Cash (bal.)	5	Op.
	cl.	13	P and L (200x9%)
			18
(W-2)	Dr.	Income tax expense	Cr.
	Cash (bal.)	8	Op.
	cl.	85	P and L
			13
(W-3)	Dr.	Machinery cost	Cr.
	b/f (bal.)	1,750cl.	1,750
(W-4)	<u>Actual Depreciation for the year</u>		
	Leasehold Land	(W-10)	5
	Building	(W-12)	50
	Machine	(W-5)	175
			230
(W-5)	Dr.	Accumulated depreciation - Machine	Cr.
	c/d	b/d (bal.)	975
		1,150 Depreciation (1,750 x 10%)	175
(W-6)	Dr.	Capital	Cr.
	c/f	1,000b/d (bal.)	1,000
(W-7)	Dr.	Accumulated Profit	Cr.
	c/d	b/d (bal.)	1,554
		1,816 PAT (275 - 13)	262
(W-8)	Dr.	Loan	Cr.
	c/d	b/d	-
		200 Cash (bal.)	200
(W-9)	Dr.	Land	Cr.
	b/d (bal.)	250	
		c/d	250
(W-10)	Dr.	Acc. Amortization	Cr.
	c/d	b/d (bal.)	195
		200 Amortization (250 x 2%)	5
(W-11)	Dr.	Building	Cr.
	b/d (bal.)	1,000	
		c/d	1,000
(W-12)	Dr.	Accumulated Depreciation - building	Cr.
	c/d	b/d (bal.)	450
		500 Depreciation (1,000 x 5%)	50

Answer-11

Quality Enterprises
Statement of cash flow
for the year ended December 31, 2015

Cash flow from Operating Activities

Profit before tax

Adjustments for:

Depreciation

Interest expense

(Gain)/ loss on sale of Machinery

Investment income

Operating cash flow before working capital changes

Adjustment for working capital changes

(Increase)/decrease in current assets

(Increase)/decrease in inventory

(Increase)/decrease in trade receivable

Increase/(Decrease) in current liabilities

Increase/(decrease) in trade payables

Working capital changes

Cash generated from operations

Less:

Interest paid

Income tax paid

Net Cash from operating activities

Cash flow from Investing Activities

Purchase of PPE

Sale proceeds from disposal of PPE- Mach.

Sale proceeds from disposal of PPE

Investment income received

Purchase of investment

Net Cash from operating activities

Cash flow from Financing Activities

Proceeds from issue of share capital

Loan raised

Drawings

Net Cash from financial activities

Net increase in cash and cash equivalents

Add: cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period

WORKINGS**(W-1) Cash and cash equivalents**

Cash and bank

Less: Bank overdraft

Rs. in '000'

7,659

5,280

100

(959)

(398)

11,682

(1,569)

1,608

(1,716)

(1,677)

10,005

(1,070)

8,935

(16,106)

3,440

2,599

382

(1,147)

(10,832)

3,516

6,000

(3,600)

5,916

4,019

(23)

3,996

2015

3,996

2014

4

(27)

(23)

3,996

(W-2)

Dr.	Property, plant and equipment	Cr.
Op.	11,845	Disposal- Machine
Revaluation surplus (8,000 - 5,963)	2,037	Depreciation
Additions (Bal.)	16,106	Disposal - Building
		cl.
		19,628

(W-3)

Dr.	Disposal - Machine	Cr.
PPE	2,481	Cash
P/L (Bal.)	959	
		3,440

(W-4)

Dr.	Investment account - at cost	Cr.
op.	6,498	
Addition (bal.)	1,147	cl.
		7,645

(W-5)

Dr.	Investment Income receivable	Cr.
op.	80	Cash (bal.)
P/L	398	cl.
		96

(W-6)

Dr.	Interest expense	Cr.
Cash	-	op.
cl. (bal.)	100	P/L (6,000 x 10% x 2 / 12)
		100

(W-7)

Dr.	Owner's capital	Cr.
		op.
cl.	14,219	Cash (bal.)
		3,516

(W-8)

Dr.	Unappropriated Profit	Cr.
Drawings (300 x 12)	3,600	op.
		Profit after tax
cl.	10,652	Revaluation Surplus (W-10)
		1,272

(W-9)

Dr.	Taxation	Cr.
Cash (bal.)	1,070	op.
cl.	1,300	P/L
		1,376

(W-10)

Dr.	Revaluation Surplus	Cr.
Unappropriated Profit (Bal.)	1,272	op.
cl.	2,676	PPE (W-2)
		2,037

(W-11)

Dr.	Disposal- Building	Cr.
PPE- Building	2,599	Cash
		P/L
		-

Answer-12

Liaquat Industries
Cash Flow Statement
For the year ended December 31, 2016

Cash flow from operating activities

Profit before tax – adjusted	(W-12)	
Add: Depreciation		
Add: Finance cost		
Less: Gain on disposal of freehold land		
Add: Loss on disposal of equipment (70,000 - 30,000)		
Profit before working capital changes		
Working capital changes		
Accounts payable (417,120 - 694,320)		
Inventory (320,628 - 685,608)		
Accounts receivable (595,452 - 1,273,272)		
Less: Interest paid	(W-12)	
Less: drawings (150,000 x 12)		
Net cash from operating activities	(A)	

Cash flow from investing activities

Sale proceeds from freehold land disposal	(W-9)	
Capital WIP investment	(W-10)	
Insurance claim from equipment	(W-8)	
Long term deposit	(W-11)	
Net cash from investing activities	(B)	

Cash flow from financing activities

Capital injected by the owner	(W-2)	
Net cash from financing activities	(C)	
Net cash flow	(A + B + C)	
Opening cash and cash equivalent	(W-1)	
Closing cash and cash equivalent		

WORKINGS

(W-1)

Cash and cash equivalent

	Closing	Opening
Cash	694,320	51,400
Short term loan	(1,331,200)	(1,331,200)
	<u>(6,36,400)</u>	<u>(1,448,720)</u>

(W-2)

	Capital account	
Drawings	1,800.00	b/d
		Profit
c/d (13,938.06 + 30,50)	13,918.06	Cash (bal.)
	<u>15,718.06</u>	

(W-3)

Cash (bal.)
c/d

Accrued interest a/c

99.632

105.60

205.23

b/d

Interest exp.

63.36

141.872

205.23

(W-4)

b/d

Freehold a/c

6,600.00

6,600.00

Disposal

c/d

1,821.60

4,778.40

6,600.00

(W-5)

b/d

CWIP

Add (wrong)

Building a/c - BV

4,171.20

1,200.00

50.00

5,421.20

Repair

Dep. (bal.)

c/d (5057.6 - 50)

50.00

363.60

5,007.60

5,421.20

(W-6)

b/d

Vehicle a/c - BV

800.00

800.00

Dep (bal.)

c/d

200.00

600.00

800.00

(W-7)

b/d

Acc. dep.

Equipment a/c - BV

2,112.00

30.00

2,142.00

Disposal

Dep. (bal.)

Cash

c/d (1643.1 + 30)

70.00

368.90

30.00

1,673.10

2,142.00

(W-8)

Equip. a/c

Disposal a/c (Equipment)

70.00

70.00

Cash

Loss

30.00

40.00

70.00

(W-9)

Land a/c

P/L a/c

Disposal a/c (Freehold land)

1,821.60

168.96

1,990.56

Cash (bal.)

1,990.56

1,990.56

(W-10)

b/d

Cash (bal.)

Capital WIP a/c

1,821.60

856.80

2,678.40

Building a/c

c/d

1,200.00

1478.40

2,678.40

(W-11)

b/d

Cash (bal.)

Long term deposits a/c

448.80

132.00

580.80

Building a/c

c/d

1,200.00

580.80

580.80

(W-12) Adjusted profit

Unadjusted net profit before tax
 Add: Insurance claim on equipment
 Less: Repair to building
 Add: Depreciation adjustment (W-13)

1,525.948
 30.00
 (50.00)

1,505.948

(W-13) Depreciation adjustment due to rectification

Depreciation before rectification - given
 Depreciation after rectification (363.6 + 200.0 + 368.9)
 Depreciation impact

932.50
932.50

(W-14) Rectifying entries

Acc. Depreciation(equipment a/c)
 P/L
 P/L (repair expense)
 Building

Dr.	Cr.
30	
	30
50	
	50

Answer-13

Nadir Limited
Statement of Cash flows

Cash flows from operating activities

	Rs.
Profit before tax	8,955
Adjustments for:	
Depreciation.	7,350
Loss on Disposal-PPE	400
Interest expense	1,100
Operating cash flows before working capital changes	17,805
Adjustments for working capital changes:	
<u>(Increase)/decrease in current assets</u>	
(Increase)/decrease in stock (5,750-5,600)	150
(Increase)/decrease in debtors (4,466-6,840)	(2,394)
(Increase)/decrease in receivables (800-12,385-1,800)	215
<u>(Increase)/decrease in current liabilities</u>	
Increase/(decrease) in creditors (1,900-1400)	500
Increase/(decrease) in other payables [(680-112)-(660-48)]	(44)
Working Capital changes	(1,573)
Cash generated from operations	16,232
Less:	
Dividend paid	(4,000)
Interest paid	(1,036)
Tax Paid	(2,795)
Net cash flows from operating activities-	<u>8,401</u>
<u>Cash flows from Investing activities</u>	A
Purchase of PPE	(14,150)
Sale proceeds from PPE- disposal	3,000
Net Cash flows from Investing activities -	<u>(11,150)</u>
	B

Cash flows from financing activities

Share raised		2,800
Loan repaid		(900)
Net Cash flows from financing activities –		1,900
Net Increase in cash & cash equivalent	C	(849)
Add: Cash & cash equivalent at the beginning	(A+B+C)	3,204
Cash & cash equivalent at the end		<u>2,355</u>

WORKINGS

(W-1)

PPE A/C

	Rs.		Rs.
Bal b/d	15,800	Disposal	5,200
Rev Surplus	4,000	Dep	7,350
Cash(Bal.)	14,150	Bal c/d	21,400
	<u>33,950</u>		<u>33,950</u>

(W-2)

Disposal A/C

	Rs.		Rs.
PPE	5,200	Cash	3000
		Receivable	1800
		Loss on disposal(bal.)	400
	<u>5,200</u>		<u>5,200</u>

(W-3)

Financial Charges

	Rs.		Rs.
cash(bal.)	1,036	b/d	48
c/d	112	p/l	1,100
	<u>1,148</u>		<u>1,148</u>

(W-4)

Tax A/C

	Rs.		Rs.
cash(bal.)	2,795	b/d	500
c/d	650	P/L	2,945
	<u>3,445</u>		<u>3,445</u>

(W-5)

Capital A/C

	Rs.		Rs.
		b/d	10,000
		Retained earnings	1,000
c/d(12,400+1,400)	13,800	Cash(bal.)	2,800
	<u>13,800</u>		<u>13,800</u>

(W-6)

Retained Earnings A/C

	Rs.		Rs.
Share capital	1,000	b/d	12,440
Dividend(bal.)	4,000	PAT(bal.)	6,010
c/d	13,450		
	<u>18,450</u>		<u>18,450</u>

(W-7) Cash & cash equivalent
Cash & bank

2017
2355

2016
3204

Answer-14

Drum Limited
Statement of cash flows
for the year ended 31 December 2018

Rs. in '000

Cash flows from operating activities

Profit before tax (W-5)	
Adjustment for:	
Depreciation	(810+480)
Gain on disposal	
Increase in provision of doubtful debts	
Interest expense	

2,910

1,290

(130)

140

378

4,588

Working capital change

Decrease in inventory	
Increase in trade receivables	
Decrease in trade payable	

400

(240)

(350)

(190)

4,398

(328)

(710)

(700)

2,660

Cash generated from operations

Interest paid	(W-1)
Tax paid	(W-2)
Dividend Paid	
Net cash flows from operating activities	(A)

2,660

Cash flows from investing activities

Purchase of land and building	(W-3)
Purchase of equipment	(W-4)
Disposal of equipment	
Net Cash flows from Investing activities	(B)

(2,130)

(2,670)

440

(4,360)

Cash flows from financing activities

Issuance of shares	
Loan repaid	
Net Cash flows from financing activities	(C)
Decrease in cash during the year	(A+B+C)

2,350

(1,000)

1350

(350)

450

100

(W-1)

Dr.

Interest payable

Cr.

Cash(Bal.)

328

B/d

C/d

50

Expense for the year

378

(W-2)

Dr.

Income tax payables

Cr.

Cash(Bal.)

710

B/d

Expense for the year

650

C/d

60

(W-3)

Dr.

Land and building

Cr.

B/d

Trade and other payables

950

Depreciation for the year

480

Cash(bal.)

2,130

C/d

2,600

(W-4)

Dr.	Equipment	Cr.
B/d	-	
Cash(bal.)	2,670	
	Depreciation for the year	810
	Disposal	310
	C/d	1,550

(W-5)

PBT (Bal.)		
Tax expense for the year		2,910
PAT		(650)
		<u>2,260</u>

(5.1)

Dr.	Retained earnings	Cr.
Dividend payable (5.2)	900	
C/d	1,360	
	B/d	-
	PAT(bal.)	2,260

(5.2)

Dr.	Dividend Payable	Cr.
Cash	700	
C/d	200	
	B/d	-
	R.E(bal.)	900

Answer-15

Sunday Traders Limited
Statement of Cash Flows
For the year ended 30 June 2019

Cash flows from operating activities

		Rs. in million
Cash receipts from customers	(W-1)	29,710
Cash receipts from tenants		184
Cash paid to suppliers	(W-2)	(18,018)
Cash paid to other vendors	(W-4)	(7,459)
Cash generated from operations		<u>4,417</u>
Interest paid	(W-6)	(1,185)
Income taxes paid	(W-7)	(940)
Net cash inflow from operating activities		<u>2,292</u>

Cash flows from investing activities

Purchase of property, plant and equipment	(W-8)	(2,241)
Proceeds from disposal of property, plant and equipment	152-40	112
Purchase of investment property	(W-9)	(460)
Net cash outflow from investing activities		<u>(2,589)</u>

Cash flows from financing activities

Proceeds from issue of shares	(W-10)	1,560
Dividend paid	(W-11, 12)	(1,200)
Repayment of loans	1,984-1,185 (W-13)	(799)
New loans acquired	(W-13)	450
Net cash inflow from financing activities		<u>11</u>
Net decrease in cash and cash equivalents		(286)
Cash and cash equivalent at the beginning of the year		480
Cash and cash equivalent at the end of the year		<u>194</u>

CHAPTER-9

Workings:

(W-1)

Debtor		Cr.
Dr.	3,600	b/d (contract liability) 40
b/d	29,700	Cash (Bal.) 29,710
Sales	250	c/d 3,800
c/d (contract liability)		

(W-2)

Creditor		Cr.
Dr.	18,018	b/d 5,390
Cash (Bal.)	3,422	Stock (Purchase) 16,050
c/d		

(W-3)

Stock		Cr.
Dr.	4,500	Cost of sales 15,750
b/d	16,050	c/d 4,800
Creditor (Purchase)		

(W-4)

Expenses		Cr.
Dr.	268	b/d (accrual) 180
b/d (Prepayment)	7,459	Expense payable (W-5) 7,673
Cash	310	c/d (prepayment) 184
c/d (accrual)		

(W-5) Expenses payable excluding non cash

Distribution cost
Administrative cost
Depreciation
Loss on disposal
Impairment
Total

Rs. in million
6,185
2,302
(750)
(40)
(24)
7,673

(W-6)

Interest payable		Cr.
Dr.	1,185	b/d 110
Cash (Bal.)	135	Interest expense 1,210
c/d		

(W-7)

Tax paid		Cr.
Dr.	940	b/d 230
Cash (Bal.)	440	Tax expense 1,150
c/d		

(W-8)

Property Plant & Equipment		Cr.
Dr.	7,240	Impairment loss 24
b/d	2,241	Disposal 152
Cash (Bal.)		Depreciation 750
		c/d 8,555

(W-9)

Investment Property		Cr.
Dr.	1,120	
b/d	220	
F V gain	460	c/d 1,800
Cash (Bal.)		

(W-10)

Dr.	Share Capital + Share Premium	Cr.
c/d (Share capital)	-	b/d (Share capital) 3,450
c/d (Share premium)	4,650	b/d (Share premium) 1,240
	1,600	Cash (Bal.) 1,560

(W-11)

Dr.	Dividend Payable	Cr.
Cash (Bal.)	1,200	b/d -
	-	Retained earning 1,200

(W-12)

Dr.	Retained Earning	Cr.
b/d	655	
Dividend payable	1,200	
c/d	1,652	Profit after tax 3,507

(W-13)

Dr.	Loan	Cr.
Cash (1984 - 1,185) (W-8)	799	b/d 6,523
(loan paid)		b/d (current portion) 700
c/d	6,024	Cash (Bal.) (Loan raised) 450
c/d (Current portion)	850	

Answer-16**BROAD PEAK LIMITED**

- Net profit is the starting point of Statement Of Cash Flows (SOCF) in indirect method, and depreciation is deducted while reaching to net profit figure, therefore, being a non-cash item, depreciation expense is added back to net profit figure to convert net profit figure into cash flow.
- IAS-07 allows interest paid to be shown as either cash flow from financing activities or cash flow from operating activities. Both classifications are correct as long as they are consistently applied by an entity.
- When adjustment of change in inventory (i.e decrease is added and increase is deducted) is made, cost of sales is automatically converted into cash outflow for purchases.
- Statement of financial position shows cash and bank balances while the statement of cash flows ends with cash and cash equivalents which may differ from cash and bank balances due to existence of bank overdraft and short term investments.

Answer-17

Taxila Limited
Statement of cash flows
for the year ended 30.06.2020

	Rs. in million
Operating activities	140
Profit before tax (W-6)	(35)
Adjustments for non cash transactions:	290
Less: Reversal of revaluation loss	10
Add: Depreciation – PPE	45
Add: Depreciation - Investment property (W-3)	(6)
Add: Interest expense	(8)
Less: Investment income	436
Less: gain on disposal of PPE	(25)
Operating profit before working capital changes	(51)
Adjustments for working capital items changes:	9
Inventories [205 - 180]	29
Trade receivables [342 - 291]	(38)
Prepayments and other receivables [20 (W-9) - 11]	
Trade and other payables [132(W-10) - 103(W-10)]	
Cash generated from operations	398
Less: Interest paid (W-11)	(50)
Cash flow from operating activities	348
Investing activities	5
Cash received from sale of PPE	(180)
Addition in investment property	(389)
Addition in property, plant and equipment (W-2)	9
Cash received in respect of investment income	(555)
Cash flow from investing activities	
Financing activities	300
Fresh share capital issued at premium [200(W-4) + 100(W-5)]	(60)
Long term loan repaid (W-8)	
Cash flow from financing activities	240
Net cash flows	33
Add: Opening cash and cash equivalent	26
Closing cash and cash equivalent	59

WORKINGS**W-1: Cash and cash equivalents**

	Closing	Opening
Short term investments	35	20
Cash and bank balances	24	6
	59	26

(W-2)	Property, plant and equipment (PPE)		
b/d	1,200	Depreciation	290
Addition	240		
R/S	80		
Cash (bal.)	389	c/d	1,619

(W-3)	Investment property		
b/d	120	Dep. (Bal.)	10
Cash	180	c/d	290

(W-4)	Share capital		
		b/d	800
		PPE	200
c/d	1,200	Cash (Bal.)	200

(W-5)	Share premium		
		b/d	150
		PPE	40
c/d	290	Cash (Bal.)	100

(W-6)	Retained earnings (R/E)		
		b/d	90
		R/S (W-7)	30
c/d	260	PAT (Bal.)	140

(W-7)	Revaluation surplus (R/S)		
R/E (Bal.)	30	b/d	200
		PPE	45
c/d	215		

(W-8)	Long term loans		
Cash (bal.)	60	b/d (445 + 60)	505
c/d (367 + 78)	445		

(W-9) Prepayments and other receivables

	Closing	Opening
As per question	14	20
Less: Receivable for PPE	(3)	-
Adjusted	11	20

(W-10) Trade and other payables

	Closing	Opening
As per question	144	120
Less: Interest payable	(12)	(17)
	132	103

(W-11)		Interest expense	
Cash (Bal.)	50	b/d	17
c/d	12	Interest expense	45
(W-12)		Short term investment	
b/d (48 - 20)	28	Cash (Bal.)	9
Investment income	6	c/d (60 - 35)	25

Journal entries (for understanding of students)		Debit	Credit
(i) PPE		240	
Share capital			200
Share premium			40
(ii) PPE		80	
P/L			35
Revaluation surplus			45
(iii) Cash		5	
Receivable for PPE		3	
P/L - gain on disposal			8

Answer-18

Satragi Limited
Statement of Cash flow
for the year ended June 30, 2021

Cash flow from Operating Activities

Profit Before tax / Loss

(W-8)

(Marks-16)
Rs.

Adjustments for non-cash item:

Less: gain on disposal of equipment

Add: Depreciation Expense

Add: Interest Expense

Operating cash flow before working capital changes

Adjustment for working capital changes

Trade receivable

Inventory

Advance to supplier

Trade payable

Accrued Expense

Less: interest Paid

Tax paid

Dividend Paid

Net cash from operating activities

A

(9)

Cash flow from Investing Activities		
Cash Received from Insurance claim	(W-5)	31
Cash received on disposal of equipment	(W-14)	52
Addition in Fixed Asset		(47)
Addition In CWIP	(W-4)	(70)
Net Cash from investing activities	B	(34)
Cash flow from Financing Activities		
New Capital Invested	(W-1)	160
D		(36)
Net cash from financing activities	C	124
Net increase in cash and cash equivalents (A+B+C)		81
Add: cash and cash equivalents at beginning of period		112
Cash and cash equivalents at end of period		193

WORKINGS

(W-1)

Cash and cash equivalents

	Cl	Op
Cash and Bank	193	112

(W-2)

Dr.	Fixed assets	Cr.
b/d	848	Disposal.
Addition.	47	c/d
		820

(W-3)

Dr.	Accumulated depreciation	Cr.
Disposal (75 - 35)	40	Op.
c/d	300	Depreciation (bal.)
		78

(W-4)

Dr.	CWIP	Cr.
b/d	0	
CWIP-Payable	14	
Addition	70	
		c/d
		84

(W-5)

Dr.	Insurance claim receivable	Cr.
b/d	31	Cash (Bal)
		c/d
		0

(W-6)

Dr.	Share Capital	Cr.
		b/d
		Cash
		Discount
c/d	700	
		500
		160
		40

CHAPTER-9

(W-7)		Share Discount	
Dr.			Cr.
b/d	0		
Share Capital	40	c/d	40

(W-8)		Retained Earnings	
Dr.			Cr.
Dividend payable (500×10%)	50	b/d	315
Loss before tax (Bal)	45		
c/d	220		

(W-9)		Long Term Loan	
Dr.			Cr.
Cash (Bal)	36	b/d (210+39)	249
c/d (175+78)	213		

(W-10)		Interest Expense	
Dr.			Cr.
Cash (Bal)	20	b/d	1
		Interest Expense (W-15)	24

(W-11)		CI		Op	
Trade Payables					
As per Q					
		180		130	
		(14)		(0)	
		166		130	

(W-12)		Payable For CWIP	
Dr.			Cr.
		b/d	0
c/d	14	CWIP	14

(W-13)		Dividend Payable	
Dr.			Cr.
Cash (Bal)	50	b/d	0
c/d	0	Retained Earning	50

(W-14)		Disposal - Fixed Asset	
Dr.			Cr.
Fixed Asset	75	Accumulated Depreciation	40
Gain	17	Cash (Bal)	52

(W-15)		Disposal - Fixed Asset	
Dr.			Cr.
Profit before interest and tax /Loss			21
Less: Interest Expense			(24)
PBT/Loss (W-8)			(45)
Less: Tax Expense			0
PAT			(45)

ICAP QUESTION BANK QUESTION**QUESTION-1**

The following information has been extracted from the financial statements of Hopper Company for the year ended 31 December 2015.

	Rs.
Sales	1,280,000
Cost of sales	(400,000)
Gross profit	880,000
Wages and salaries	(290,000)
Other expenses (including depreciation Rs. 25,000)	(350,000)
Interest charges	240,000
Profit before tax	(50,000)
Tax on profit	190,000
Profit after tax	(40,000)
Extracts from the statement of financial position:	150,000

	At 1 January 2015 Rs.	At 31 December 2015 Rs.
Trade receivables	233,000	219,000
Inventory	118,000	124,000
Trade payables	102,000	125,000
Accrued wages and salaries	8,000	5,000
Accrued interest charges	30,000	45,000
Tax payable	52,000	43,000

Required: Using the above information, prepare cash flows from operating activities section of statement of cash flows for Hopper Limited using indirect and direct method.

(ICAP Example 4 & 5)

QUESTION-2

From the following information, calculate the cash flows from financing activities for Company X in 2017.

	Beginning of 2017 Rs.	End of 2017 Rs.
Share capital (ordinary shares)	400,000	500,000
Share premium	275,000	615,000
Retained earnings	390,000	570,000
	1,065,000	1,685,000
Loans repayable after more than 12 months	600,000	520,000
Loans repayable within 12 months or less	80,000	55,000

The company made a profit of Rs. 420,000 for the year after taxation.

Required

Calculate for 2017, for inclusion in the statement of cash flows:

- the cash from issuing new shares
- the cash flows received or paid for loans
- The payment of dividend to ordinary shareholders.

(ICAP Example 9)

QUESTION-3

Following are the extracts from the financial statements of Universal Limited (UL) for the year ended 30 June 2017:

Statement of financial position as on 30 June 2017

Assets	2017 Rs. in '000	2016 Rs. in '000	Equity & liabilities	2017 Rs. in '000	2016 Rs. in '000
Property, plant and equipment	158,500	120,000	Share capital (Rs. 10each)	175,000	150,000
Stock in trade	58,000	45,000	Retained earnings	54,434	21,500
Income tax refundable	8,500	-	Revaluation surplus	10,000	-
Trade receivables	68,000	56,000	Debentures (Rs. 100each)	18,000	20,000
Cash	39,434	48,000	Interest payable	1,000	2,500
			Trade payables	42,000	39,000
			Accrued liabilities	20,000	18,000
			Unearned maintenance	2,000	4,000
			Provision for taxation	10,000	14,000
	332,434	269,000		332,434	269,000

Statement of profit or loss for the year ended 30 June 2017

	Rs. in '000
Sales	273,000
Cost of sales	(187,500)
Gross profit	85,500
Operating expenses	(46,766)
Other income	11,200
Profit before interest and tax	49,934
Interest expense	(2,000)
Profit before tax	47,934
Tax expense	(15,000)
Profit after tax	32,934

Additional information:

- 60% of sales were made on credit.
- UL maintains a provision for doubtful receivables at 6%. During the year, trade receivables of Rs. 7 million were written off.
- Depreciation expense for the year was Rs. 22.5 million. 70% of the depreciation was charged to cost of sales.
- Other income comprises of:
 - gain of Rs. 3 million on disposal of vehicles for Rs. 12 million;
 - maintenance income of Rs. 8 million; and

discount of Rs. 10 per debenture which were redeemed during the year.

Required: Based on the above information, prepare UL's statement of cash flows for the year ended 30 June 2017 using direct method.

(ICAP Example 10)

QUESTION-4

The following information has been extracted from the financial statements of Trango Limited for the year ended 31 December 2015.

Statement of comprehensive income for the year ended 31 December 2015

	Rs.
Sales	905,000
Cost of sales	(311,000)
Gross profit	594,000
Loss on disposal of non-current asset	(9,000)
Wages and salaries	(266,000)
Other expenses (including depreciation Rs. 46,000)	(193,000)
	126,000
Interest charges	(24,000)
Profit before tax	102,000
Tax on profit	(38,000)
Profit after tax	64,000

The asset disposed of had a carrying amount of Rs. 31,000 at the time of sale.

Extracts from the statements of financial position:

	1 January 2015	31 December 2015
	Rs.	Rs.
Trade receivables	157,000	173,000
Inventory	42,000	38,000
Trade payables	43,600	35,700
Accrued wages and salaries	4,000	4,600
Accrued interest charges	11,200	10,000
Tax payable	45,000	41,000

Required

Present the cash flows from operating activities as they would be presented in a statement of cash flows:

- using the direct method
- using the indirect method.

(ICAP Example 11)

QUESTION-5

The following information has been extracted from the draft financial information of Nardone Limited.

Statement of comprehensive income for the year ended 31 December 2015

	Rs.in 000	Rs. in 000
Sales revenue		490
Administration costs	(86)	
Distribution costs	(78)	(164)
Operating profit		326
Interest expense		(23)
Profit before tax		303
Taxation		(87)
Profit after tax		216

Statements of financial position

	31 December 2015		31 December 2014	
	Rs.in 000	Rs.in 000	Rs.in 000	Rs.in 000
		1,145		957
Non-current assets (see below)				
Current assets:	19		16	
Inventory	38		29	
Receivables	19	76	32	77
Bank		1,221		1,034
Total assets		323		232
Share capital		170		0
Revaluation reserve		553		389
Retained earnings		1,046		621
Non-current liabilities:		70		320
Long-term loans				
Current liabilities:				
Trade payables	12		17	
Tax payable	93	105	76	93
Total equity and liabilities		1,221		1,034
Note on non-current assets				

	Land and buildings	Machinery	Fixtures & fittings	Total
	Rs. in 000	Rs. in 000	Rs. in 000	Rs. in 000
Cost or valuation				
At 31 December 2014	830	470	197	1,497
Additions	-	43	55	98
Disposals	-	(18)	-	(18)
Adjustment on revaluation	70	-	-	70
At 31 December 2015	900	495	252	1,647
Depreciation				
At 31 December 2014	(90)	(270)	(180)	(540)
Charge for the year	(10)	(56)	(8)	(74)
Disposals	-	12	-	12
Adjustment on revaluation	100	-	-	100
At 31 December 2015	0	(314)	(188)	(502)
Carrying amount:				
At 31 December 2014	740	200	17	957
At 31 December 2015	900	181	64	1,145

You have been informed that included within distribution costs is Rs. 4,000 relating to the loss on a disposal of a non-current asset.

Required

Prepare a statement of cash flows for Nardone Limited for the year ended 31 December 2015.

(ICAP Example 12)

QUESTION-6

Hot Sauce Limited summarized final accounts are as follows

Statements of financial position

	31 December 2014		31 December 2015	
	Rs. in 000	Rs. in 000	Rs. in 000	Rs. in 000
Non-current assets:				
Plant and machinery at cost		2,700		3,831
Accumulated depreciation		(748)		(1,125)
Carrying amount		1,952		2,706
Current assets:				
Inventory	203		843	
Receivables	147		184	
Bank	51		-	
Total assets		401		1,027
Ordinary share capital (Rs 1 shares)		2,353		3,733
Share premium account		740		940
Retained earnings		0		100
		671		1,034
		1,411		2,074
Non-current liabilities:				
Loans		320		150
Current liabilities:				
Bank overdraft	0		766	
Trade payables and Accruals	152		141	
Current taxation	470	622	602	1,509
Total equity and liabilities		2,353		3,733

Statement of comprehensive income for year ended 31 December 2015

	Rs. in 000
Profit before tax	1,195
Taxation	(602)
Profit after tax	593

Dividend payments during the year were Rs.230,000.

The following information is also available:

- 1) The only new loan raised during the year was a five-year bank loan amounting to Rs.65,000.
- 2) Interest charged during the year was Rs. 156,000. Interest was accrued Rs.24,000 last year and Rs.54,000 this year.
- 3) Depreciation charged during the year amounted to Rs.401,000. This does not include any profit or loss on disposal of non-current assets.
- 4) During the year plant which originally cost Rs.69,000 was disposed of for Rs.41,000.
- 5) During the year the company issued 200,000 new shares.

Required

Prepare a statement of cash flows.

(ICAP Example 13)

QUESTION-7

The financial statements of Quetta Track Limited, a limited liability company, at 30 June were as follows.

	2015		2014	
	Rs. in 000	Rs. in 000	Rs. in 000	Rs. in 000
ASSETS				
Non-current assets				
Property cost	22,000		12,000	
Depreciation	(4,000)	18,000	(1,000)	11,000
Plant and equipment cost	5,000		5,000	
Depreciation	(2,250)	2,750	(2,000)	3,000
		20,750		14,000
Current assets				
Inventories	16,000		11,000	
Trade receivables	9,950		2,700	
Cash and cash equivalents	-	25,950	1,300	15,000
Total assets		46,700		29,000
	Rs. in 000	Rs. in 000	Rs. in 000	Rs. in 000
EQUITY AND LIABILITIES				
Capital and reserves				
Equity capital		3,000		3,000
Accumulated profits		16,200		3,800
		19,200		6,800
Non-current liabilities				
Loan		6,000		10,000
Current liabilities				
Operating overdraft	11,000		-	
Trade payables	8,000		11,000	
Income tax payable	1,800		1,000	
Accrued interest	700	21,500	200	12,200
Total equity and liabilities		46,700		29,000
Statement of comprehensive income (extracts)				
			2015	2014
			Rs. in 000	Rs. in 000
Operating profit			15,400	5,900
Financing cost (Interest)			(1,000)	(1,400)
Profit before tax			14,400	4,500
Income tax expense			(2,000)	(1,500)
Net profit for the year			12,400	3,000

Equipment of carrying amount Rs. 250,000 was sold at the beginning of 2015 for Rs. 350,000. This equipment had originally cost Rs. 1,000,000.

In recent years, no dividends have been paid.

Required:

Prepare a statement of cash flows, under the indirect method, for the year ended 30 June 2015.

(ICAP Example 14)

QUESTION-8

The following are the summarized accounts of Mardan Software Limited, a limited liability company.

Statements of financial position at 31 December

	2014		2015	
	Rs. in 000	Rs. in 000	Rs. in 000	Rs. in 000
ASSETS				
Non-current assets				
Plant and equipment		2,086		2,103
Fixtures and fittings		1,381		1,296
		<u>3,467</u>		<u>3,399</u>
Current assets				
Inventory	1,292		1,952	
Trade receivables	713		1,486	
Short term investment	1,050		600	
Cash	<u>197</u>	<u>3,252</u>	<u>512</u>	<u>4,550</u>
Total assets		<u>6,719</u>		<u>7,949</u>
EQUITY AND LIABILITIES				
Capital and reserves				
Equity capital		4,200		4,500
Share premium reserve		800		900
Accumulated profits (Note 1)		<u>431</u>		<u>1,180</u>
		<u>5,431</u>		<u>6,580</u>
Current liabilities				
Dividend payable	132		154	
Income tax payable	257		312	
Trade payables	<u>899</u>	<u>1,288</u>	<u>903</u>	<u>1,369</u>
Total equity and liabilities		<u>6,719</u>		<u>7,949</u>

Statement of comprehensive income (extracts) for the year ended 31 December 2015

	Rs. in 000
Profit before taxation	1,381
Income tax expense	<u>(310)</u>
Net profit for the period	<u>1,071</u>
Note 1 Accumulated profits	
	Rs. in 000
Balance at 1 January	431
Net profit for period	1,071
Dividend for the year	<u>(322)</u>
Balance at 31 December	<u>1,180</u>

Further information:

- (1) Plant and equipment with a carrying amount of Rs.184,000 was disposed of for Rs. 203,000, whilst a new item of plant was purchased for Rs.312,000
- (2) Fixtures and fittings with a carrying amount of Rs. 100,000 were disposed of for Rs. 95,000;
- (3) Depreciation recognized on fixtures and fittings amounted to Rs. 351,000.
- (4) Dividend for the year was declared during the year. Dividend payable in the statements of financial position at each year end relate to dividends declared in that year but not paid over to shareholders by the reporting date.

Required:

Prepare a statement of cash flows for the year ended 31 December 2015 in accordance with IAS 7:
(ICAP Example 15)

Statement of cash flows

QUESTION-9

Tarbela Traders is the trading name of a sole trader.

The statements of financial position of Tarbela Traders at the end of two consecutive financial years were:

	Statements of financial position at			
	31 December 2015	31 December 2015	31 December 2014	31 December 2014
	Rs. in 000	Rs. in 000	Rs. in 000	Rs. in 000
Non-current assets (at WDV)				
Premises	37,000		38,000	
Equipment	45,800		17,600	
Motor vehicles	18,930	101,730	4,080	59,680
Investments		25,000		17,000
		<u>126,730</u>		<u>76,680</u>
Current assets				
Inventories	19,670		27,500	
Trade receivables and prepayments	11,960		14,410	
Short-term investments	4,800		3,600	
Cash and bank balances	700	37,130	1,800	47,310
		<u>163,860</u>		<u>123,990</u>
Total assets				
Capital and reserves				
Share Capital	67,940		67,940	
Retained	10,670		7,100	
		78,610		75,040
Non-current liabilities				
Interest-bearing borrowings		25,000		28,000
Current liabilities				
Trade payables and accrued expenses	32,050		20,950	
Bank overdraft	28,200	60,250	-	20,950
		<u>163,860</u>		<u>123,990</u>

Profit for the year ended 31 December 2015 is Rs. 3,570,000 (after accounting for):

	Rs. in 000
Depreciation	
Premises	1,000
Equipment	3,000
Motor vehicles	3,000
Profit on disposal of equipment	430
Loss on disposal of motor vehicle	740
Interest expense	3,000

The written down value of the assets at date of disposal was:

	Rs. in 000
Equipment	5,200
Motor vehicles	2,010

Interest accrued at 31 December 2015 is Rs. 400,000.

Required:

Prepare a statement of cash flows for the year ended 31 December 2015. Assume that short-term investments are cash equivalents.

(ICAP Example 16)

QUESTION-10

The statements of financial position and statement of comprehensive incomes of The Sindh Robotics Company for two consecutive financial years are shown below.

Statements of financial position

	31 December 2013			31 December 2014		
	Cost Rs. in 000	Dep Rs. in 000	Net Rs. in 000	Cost Rs. in 000	Dep Rs. in 000	Net Rs. in 000
Non-current assets						
Land	43,000	-	43,000	63,000	-	63,000
Buildings	50,000	10,000	40,000	90,000	11,000	79,000
Plant	10,000	4,000	6,000	11,000	5,000	6,000
	<u>103,000</u>	<u>14,000</u>	<u>89,000</u>	<u>164,000</u>	<u>16,000</u>	<u>148,000</u>
Investments			50,000			80,000
Current assets						
Inventories		55,000			65,000	
Trade receivables		40,000			50,000	
Bank		3,000	98,000		-	115,000
			<u>237,000</u>			<u>343,000</u>
Capital						
Issued shares of Rs. 1 each		40,000			50,000	
Share premium		12,000			14,000	
Revaluation surplus		-			20,000	
Accumulated profit		25,000	77,000		25,000	109,000
Non-current liabilities						
10% loan borrowings			100,000			150,000
Current liabilities						
Trade payables		40,000			60,000	
Dividend payable		20,000			20,000	
Bank overdraft		-	60,000		4,000	84,000
			<u>237,000</u>			<u>343,000</u>

Statements of comprehensive incomes

	2013 Rs.000	2014 Rs.000
Revenue	200,000	200,000
Cost of sales	(100,000)	(120,000)
Gross profit	100,000	80,000
Distribution and administration expenses	(50,000)	(47,000)
	50,000	33,000
Interest	(10,000)	(13,000)
Net profit for the year	40,000	20,000

Only one dividend is declared each year which is paid in the following year. No sales of non-current assets have occurred during the relevant period. Ignore taxation.

Required:

Prepare a statement of cash flows for the year ended 31 December 2014 using the direct method.

(ICAP Example 17)

QUESTION-11

Abida Ltd. made a net profit of Rs. 256,800 for the year ended June 30, 2015 after charging depreciation of Rs. 17,500 and loss on disposal of furniture of Rs. 6,800. The sale proceeds of the furniture were Rs. 12,000.

During the year, the net book value of non-current assets decreased by Rs. 7,400; receivables increased by Rs. 11,700; inventories decreased by Rs. 21,600 and creditors increased by Rs. 8,900. A long-term loan of Rs. 75,000 was repaid during the year and Abida withdrew Rs. 120,000 for her own use.

Required:

Prepare the statement of cash flows for the year ended June 30, 2015.

(ICAP Example 18)

QUESTION-12

The statement of financial position and statement of profit or loss for Klea for the year to 31st March 2015 are provided below.

Statement of financial position as at 31st March 2015

	2015	2014
	Rs. in '000	
Assets		
Non-current assets		
Intangible assets	300	200
Property, plant and equipment	3,450	1,600
Long term investments	400	200
	<u>4,150</u>	<u>2,000</u>
Current assets		
Inventory	3,200	2,000
Trade receivables	2,400	2,000
Cash and cash equivalents	32	580
	<u>5,632</u>	<u>4,580</u>
Total assets	<u>9,782</u>	<u>6,580</u>
Equity and liabilities		
Equity		
Issued share capital	3,000	2,000
Share premium account	838	560
Retained earnings	910	354
Total equity	<u>4,748</u>	<u>2,914</u>
Revaluation surplus	1,000	-
Non-current liabilities		
Interest-bearing loans and liabilities	1,600	2,000
Current liabilities		
Bank overdraft	414	-
Trade payables	1,600	1,266
Taxation	420	400
	<u>2,434</u>	<u>1,666</u>
Total liabilities	<u>4,034</u>	<u>3,666</u>
Total equity and liabilities	<u>9,782</u>	<u>6,580</u>

Statement of profit or loss for the year ended 31st March 2015

Revenue	10,000
Other income	100
Change in inventory of finished goods and WIP	1,300
Raw materials and consumables used	4,000
Employee benefits costs	3,000
Depreciation and amortisation expense	800
Other expenses	1,724
Total expenses	(9,524)
Finance costs	1,876
Finance income	(320)
Profit before tax	50
Income tax expense	1,606
Profit for the year	(650)
	956

Additional information

(i) Non-current assets

Rs. in '000

	2015		2014	
	Cost	Deprec'n	Cost	Deprec'n
Intangible assets	700	400	400	200
Property, plant and equipment	5,000	1,550	3,000	1,400

- (ii) At 1 April 2014 land was revalued from Rs. 1 million to Rs. 2 million.
- (iii) During the year, plant and machinery costing Rs. 600,000 and depreciated by Rs. 500,000 was sold for Rs. 150,000.
- (iv) The interest bearing loans relate to debentures which were issued at their nominal value. Rs. 400,000 of these debentures was redeemed at par during the year.
- (v) Ordinary shares were issued for cash during the year.
- (vi) Rs. 100,000 of current asset investments held as cash equivalents were sold during the year for Rs. 94,000.

Dividends paid in the year were Rs. 200,000 relating to the 2014 proposed dividend and Rs. 200,000 interim dividends for 2015.

Required:

Prepare a statement of cash flows for Klea for the year ended 31 March 2015 in accordance with IAS 7 using the indirect method.

(ICAP Example 26)

ICAP QUESTION BANK SOLUTIONS**Answer-1**

The calculation is as under:

The cash flows from operating activities using the indirect method is as under:

	Rs.
Statement of cash flows	
Cash flows from operating activities	
Profit before taxation	190,000
Adjustments for:	
Depreciation charges	25,000
Interest expense	50,000
	<hr/>
	265,000
Decrease in trade receivables (233,000 – 219,000)	14,000
Increase in inventories (124,000 – 118,000)	(6,000)
Increase in trade and other payables (125,000 + 5,000) – (102,000 + 8,000)	20,000
	<hr/>
Cash generated from operations	293,000
Taxation paid (W1)	(49,000)
Interest paid (W1)	(35,000)
	<hr/>
Net cash flow from operating activities	209,000

Workings**(W1) Interest and tax payments**

	Tax Rs.	Interest Rs.
Liability at the beginning of the year	52,000	30,000
Taxation charge/interest charge for the year	40,000	50,000
	<hr/>	<hr/>
	92,000	80,000
Liability at the end of the year	(43,000)	(45,000)
	<hr/>	<hr/>
Tax paid/interest paid during the year	49,000	35,000

Direct method**Statement of cash flows: direct method**

	Rs.
Cash flows from operating activities	
Cash receipts from customers(W1)	1,294,000
Cash payments to suppliers(W3)	(383,000)
Cash payments to employees(W4)	(293,000)
Cash paid for other operating expenses	(325,000)
	<hr/>
Cash generated from operations	293,000
Taxation paid (tax on profits)(W5)	(49,000)
Interest charges paid(W5)	(35,000)
	<hr/>
Net cash flow from operating activities	209,000

Workings**(W1) Cash from sales**

Trade receivables at 1 January 2015

Sales in the year

Trade receivables at 31 December 2015

Cash from sales during the year

(W2) Purchases

Closing inventory at 31 December 2015

Cost of sales

Opening inventory at 1 January 2015

Purchases in the year

(W3) Cash paid for materials supplies

Trade payables at 1 January 2015

Purchases in the year (W2)

Trade payables at 31 December 2015

Cash paid for materials

(W4) Cash paid for wages and salaries

Accrued wages and salaries at 1 January 2015

Wages and salaries expenses in the year

Accrued wages and salaries at 31 December 2015

Cash paid for wages and salaries

(W5) Interest and tax payments

Liability at the beginning of the year

Taxation charge/interest charge for the year

Liability at the end of the year

Tax paid/interest paid during the year

Answer-2

Proceeds from new issue of shares

Share capital and share premium:

At the end of the year (500,000 + 615,000)

At the beginning of the year (400,000 + 275,000)

Proceeds from new issue of shares during the year

Rs.

233,000

1,280,000

1,513,000

(219,000)

1,294,000

Rs.

124,000

400,000

524,000

(118,000)

406,000

Rs.

102,000

406,000

508,000

(125,000)

383,000

Rs.

8,000

290,000

298,000

(5,000)

293,000

Tax

Interest

Rs.

Rs.

52,000

30,000

40,000

50,000

92,000

80,000

(43,000)

(45,000)

49,000

35,000

Rs.

1,115,000

(675,000)

440,000

CHAPTER-9

Repayment of loans

Loans repayable:

At the end of the year (520,000 + 55,000)

At the beginning of the year (600,000 + 80,000)

Repayment of loans during the year

Rs.

575,000

(680,000)

105,000

Rs.

390,000

420,000

810,000

(570,000)

240,000

Payment of dividends

Retained earnings at the beginning of the year

Profit after taxation for the year

Retained earnings at the end of the year

Dividends paid during the year

Cash flows from financing activities can now be presented as follows.

Cash flows from financing activities

Proceeds from issue of shares

Repayment of loans

Dividends paid to shareholders

Net cash from financing activities

Rs.

440,000

(105,000)

(240,000)

Rs.

95,000

Answer-3**Statement of Cash Flows****For the year ended 30 June 2017**

		Rs. in '000
Cash flows from operating activities		
Cash receipts from customers	(W-1)	253,234
(Cashsales: 109,200; Credit sales: 144,034)	(W-2)	6,000
Cash receipts from customers - maintenance services	(W-3)	(181,750)
Cash paid to suppliers	(W-4)	(30,250)
Cash paid to other vendors		(27,500)
Income taxes paid (8,000+6,000+15,000-10,000+8,500)		(3,500)
Interest paid (2,500+2,000-1,000)		16,234
Net cash inflow from operating activities		

		Rs. in '000
Cash flows from investing activities		
Purchase of property, plant and equipment		(60,000)
[120,000-158,500-9,000(i.e. 12,000-3,000)-22,500+10,000]		12,000
Proceeds from disposal of vehicles		(48,000)
Net cash outflow from investing activities		
Cash flows from financing activities		
Redemption of debentures [(20,000-18,000)-(20×10)]		(1,800)
Proceeds from issue of shares (175,000-150,000)		25,000
Net cash inflow from financing activities		23,200

Net decrease in cash and cash equivalents	
Cash and cash equivalent at the beginning of the year	(8,566)
Cash and cash equivalent at the end of the year	48,000
	39,434

Workings:**W-1: Cash receipts from customers - sales**

Trade receivables – opening (56,000 ÷ 0.94)	59,574
Sales for the year	273,000
Bad debts written off	(7,000)
Trade receivables – closing (68,000 ÷ 0.94)	(72,340)
Cash received from customers	253,234
Unearned maintenance – opening	(4,000)
Maintenance income for the year	8,000
Unearned maintenance – closing	2,000
	6,000

W-3: Cash paid to suppliers

	----- Rs. in '000 -----	
Trade payables – opening		39,000
Add: Purchases / Manufacturing cost		
Stock in trade – closing	58,000	
Cost of goods sold less dep. [187,500 – (22,500 × 70%)]	171,750	
Stock in trade – opening	(45,000)	184,750
Less: Trade payables – closing		(42,000)
Cash paid to suppliers		181,750

W-4: Cash paid to other vendors

	Rs. in '000
Accrued liabilities – opening	18,000
Operating expense for the year	46,766
Depreciation (22,500 × 30%)	(6,750)
Bad debt expense (W-4.1)	(7,766)
Accrued liabilities – closing	(20,000)
	30,250

W-4.1: Bad debts expense for the year

Provision for doubtful receivables – opening (56,000 ÷ 0.94 × 0.06)	(3,574)
Bad debts written off	7,000
Provision for doubtful receivable – closing (68,000 ÷ 0.94 × 0.06)	4,340
	7,766

Answer-4**Cash flow Direct method****Cash flow from Operating Activities**

		Rs.
Cash receipts from customers	(W-1)	889,000
Cash paid to suppliers	(W-2)	(314,900)
Cash paid against salaries and wages	(W-3)	(265,400)
Cash paid against other expenses (193,000 - 46,000)	(Given)	(147,000)
Cash generated from operations		161,700

Less:

Interest paid

(W-4)

Income tax paid

(W-5)

Net Cash from operating activities

(25,200)

(42,000)

94,500

WORKINGS

(W-1)

Trade receivables

b/d

157,000

Cash (bal.)

Sales

905,000

c/d

889,000

173,000

(W-2)

Trade payables

Cash (bal.)

314,900

b/d

c/d

35,700

Inventory

(W-2.1)

43,600

307,000

(W-2.1)

Inventory

b/d

42,000

Cost of Sales

Purchases (bal.)

307,000

c/d

311,000

38,000

(W-3)

Wages and salaries

Cash (bal.)

265,400

b/d

c/d

4,600

P and L

4,000

266,000

(W-4)

Interest expense

Cash (bal.)

25,200

b/d

c/d

10,000

P and L

11,200

24,000

(W-5)

Income tax expense

Cash (bal.)

42,000

b/d

c/d

41,000

P and L

45,000

38,000

Cash flow indirect method**Cash flow from Operating Activities**

Profit before tax

Rs.

Adjustments for:

102,000

Depreciation

Loss on sale of non-current assets

46,000

Interest expense

9,000

Operating cash flow before working capital changes

24,000

Adjustment for working capital changes

181,000

(increase)/decrease in current assets

(Increase)/decrease in inventories

(Increase)/decrease in trade receivables

4,000

Increase/(Decrease) in current liabilities

(16,000)

Increase/(decrease) in trade payables

(7,900)

Increase/(decrease) in accrued expenses

600

Working capital changes

(19,300)

Cash generated from operations

161,700

Less:

Interest paid

(W-1)

Income tax paid

(W-2)

Net Cash from operating activities

(25,200)

(42,000)

94,500

WORKINGS

(W-1)

Cash (bal.)
cl.

Interest expense

25,200

10,000

op.

P and L

11,200

24,000

(W-2)

Cash (bal.)
cl.

Income tax expense

42,000

41,000

op.

P and L

45,000

38,000

Answer-5

Cash flow indirect method

Cash flow from Operating Activities

Profit before tax

Adjustments for:

Depreciation

Loss on sale of non-current assets

Interest expense

Operating cash flow before working capital changes

Adjustment for working capital changes

(Increase)/decrease in current assets

(Increase)/decrease in inventories

(Increase)/decrease in trade receivables

Increase/(Decrease) in current liabilities

Increase/(decrease) in trade payables

Working capital changes

Cash generated from operations

Less:

Interest paid

Dividend paid

Income tax paid

Net Cash from operating activities

Cash flow from Investing Activities

Purchase of fixed assets

Sale proceeds from disposal of fixed assets

Net cash from investing activities

Cash flow from Financing Activities

Proceeds from issue of share capital

Long term loan repaid

Net cash from financial activities

Net increase in cash and cash equivalents

Add: cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period

WORKINGS

(W-1) Cash and cash equivalents

Bank

Rs in '000'

303

74

4

23

404

(3)

(9)

(5)

(17)

387

(23)

(52)

(70)

242

(98)

2

(96)

91

(250)

(159)

(13)

32

19

2015	2014
19	32
19	32

		Asset Disposal Account	
(W-2)	Cost	18	Accumulated depreciation
			P and L
			Cash (bal.)
			12
			4
			2
		Loan account	
(W-3)	Cash (repaid) (bal.)	250	Op.
	cl.	70	
			320
		Income tax expense	
(W-4)	Cash (repaid) (bal.)	70	Op.
	cl.	93	P and L
			76
			87
		Retained Earnings	
(W-5)	Cash (repaid) (bal.)	52	Op.
	cl.	553	P and L
			389
			216

Answer-6**Cash flow indirect method****Cash flow from Operating Activities**

Profit before tax

Rs in '000'

Adjustments for:

Depreciation

Loss on sale of non-current assets

Interest expense

Operating cash flow before working capital changes

Adjustment for working capital changes

(Increase)/decrease in current assets

(Increase)/decrease in inventories

(Increase)/decrease in trade receivables

Increase/(Decrease) in current liabilities

Increase/(decrease) in trade payables

Working capital changes

Cash generated from operations

Less:

Interest paid

Dividend paid

Income tax paid

Net Cash from operating activities

Cash flow from Investing Activities

Purchase of property, plant and equipment

Sale proceeds from disposal of non-current asset

Net cash from investing activities

Cash flow from Financing Activities

Proceeds from issue of share capital

Long term loan raised

Long term loan repaid

Net cash from financial activities

Net increase in cash and cash equivalents

Add: cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period

(W-7)

(W-8) (128 - 87)

(W-3)

(W-4)

A

(W-5)

B

(940 - 740) + (100-0)

(W-2)

C

(A+B+C)

(W-1)

(W-1)

1,195

401

4

156

1,756

(640)

(37)

(41)

(718)

1,038

(126)

(230)

(470)

212

(1,200)

41

(1,159)

300

65

(235)

130

(817)

51

(766)

WORKINGS**(W-1) Cash and cash equivalents**

	2014	2015
Bank	51	-
Bank overdraft	-	(766)
	<u>51</u>	<u>(766)</u>

(W-2)

	Loan account	
Cash (repaid) (bal.)	235	Op.
cl.	150	Cash (raised)
		320
		65

(W-3)

	Interest expense	
Cash (bal.)	126	Op.
cl.	54	P and L
		24
		156

(W-4)

	Income tax expense	
Cash (bal.)	470	Op.
cl.	602	P and L
		470
		602

(W-5)

	Plant and machinery at cost	
op.	2,700	Disposal
Cash (additions) (bal.)	1,200	cl.
		69
		3,831

(W-6)

	Accumulated depreciation	
Disposal (bal.)	24	op.
cl.	1,125	Depreciation
		748
		401

(W-7)

	Disposal Account	
Cost	69	Accumulated depreciation (W-6)
		24
		Cash
		41
		P/L (bal.)
		4

(W-8) Trade and other payables

	2014	2015
Trade payables and accruals	152	141
Less: Interest accrued	(24)	(54)
	<u>128</u>	<u>87</u>

Answer-7**Cash flow indirect method****Cash flow from Operating Activities**

Profit before tax

Adjustments for:

Depreciation

(Gain)/ loss on sale of fixed assets

Interest expense

Operating cash flow before working capital changes

Adjustment for working capital changes

(Increase)/decrease in current assets

(Increase)/decrease in inventories

(Increase)/decrease in trade receivables

Increase/(Decrease) in current liabilities

Increase/(decrease) in trade payables

Increase/(decrease) in accrued expenses

Working capital changes

Cash generated from operations

Rs in '000'

14,400

((W-6) 3,000 + (W-8) 1,000)

(W-9)

4,000

(100)

1,000

19,300

(5,000)

(7,250)

(3,000)

(15,250)

4,050

Less:		
Interest paid	(W-3)	(500)
Income tax paid	(W-4)	(1,200)
Net Cash from operating activities	A	2,350

Cash flow from Investing Activities

Purchase of fixed assets		
- Property	(W-5)	(10,000)
- Plant and equipment	(W-7)	(1,000)
Sale, proceeds from disposal of fixed assets		350
Net cash from investing activities	B	(10,650)

Cash flow from Financing Activities

Proceeds from issue of share capital		
Long term loan repaid	(W-2)	(4,000)
Net cash from financial activities	C	(4,000)
Net increase in cash and cash equivalents	(A+B+C)	(12,300)
Add: cash and cash equivalents at beginning of period	(W-1)	1,300
Cash and cash equivalents at end of period	(W-1)	(11,000)

WORKINGS**(W-1) Cash and cash equivalents**

Bank	2015	2014
Bank overdraft	(11,000)	1,300
	(11,000)	1,300

(W-2)	Loan Account	
Cash (repaid) (bal.)	4,000	op.
cl.	6,000	10,000

(W-3)	Interest expense	
Cash (bal.)	500	op.
cl.	700	P and L
		200
		1,000

(W-4)	Income tax expense	
Cash (bal.)	1,200	op.
cl.	1,800	P and L
		1,000
		2,000

(W-5)	Property at cost	
op.	12,000	Disposal
Cash (additions) (bal.)	10,000	cl.
		22,000

(W-6)	Accumulated depreciation	
cl.	4,000	op.
		Depreciation (bal.)
		1,000
		3,000

(W-7)	Plant and equipment at cost	
op.	5,000	Disposal
Cash (additions) (bal.)	1,000	cl.
		1,000
		5,000

(W-8)		Accumulated depreciation	
Disposal (1,000 - 250)	750	op.	2,000
cl.	2,250	Depreciation (bal.)	1,000
(W-9)		Disposal Account	
Cost	1,000	Accumulated depreciation (W-8)	750
P and L (bal.)	100	Cash	350

Answer-8**Cash flow indirect method****Cash flow from Operating Activities**

Profit before tax		Rs.
Adjustments for:		1,381
Depreciation		
Gain on sale of plant and equipment	(W-4)(111+351)	462
Loss on sale of fixture and fitting	(W-5)	(19)
	(W-7)	5
		1,829
Operating cash flow before working capital changes		
Adjustment for working capital changes		
(Increase)/decrease in current assets		
(Increase)/decrease in inventories		(660)
(Increase)/decrease in trade receivables		(773)
Increase/(Decrease) in current liabilities		
Increase/(decrease) in trade payables		4
Working capital changes		(1,429)
Cash generated from operations		400
Less:		
Dividend paid	(W-3)	(300)
Income tax paid	(W-2)	(255)
Net Cash from operating activities	A	(155)

Cash flow from Investing Activities

Purchase of fixed assets		
- Plant and equipment		(312)
- Fixture and fitting	(W-6)	(366)
Sale proceeds from disposal		
- Plant and equipment		203
- Fixture and fitting		95
Net cash from investing activities	B	(380)

Cash flow from Financing Activities

Proceeds from issue of share capital	(4,500 - 4,200) + (900 - 800)	400
Net cash from financial activities	C	400
Net increase in cash and cash equivalents	(A+B+C)	(135)
Add: cash and cash equivalents at beginning of period	(W-1)	1,247
Cash and cash equivalents at end of period	(W-1)	1,112

WORKINGS

(W-1) Cash and cash equivalents

Cash
Short term investment

2014	2015
197	512
1,050	600
1,247	1,112

(W-2)	Income tax expense	
Cash (bal.)	255	op.
cl.	312	P and L
		257
		310

(W-3)	Dividend payable	
Cash (bal.)	300	op.
cl.	154	Dividend
		132
		322

(W-4)	Plant and equipment at book value	
op.	2,086	Depreciation (bal.)
Cash (additions)	312	Disposal - BV
		cl.
		111
		184
		2,103

(W-5)	Disposal Account	
Asset at book value	184	
P and L (bal.)	19	Cash
		203

(W-6)	Fixture and fitting at book value	
op.	1,381	Depreciation
Cash (additions) (bal.)	366	Disposal
		cl.
		351
		100
		1,296

(W-7)	Disposal Account	
Asset at book value	100	Cash
		P and L (bal.)
		95
		5

Answer-9**Cash flow indirect method**

Rs.000"

Cash flow from Operating Activities

Profit before tax

Adjustments for:

Depreciation

(1,000+3,000+3,000)

Gain on sale of equipment

Loss on sale of motor vehicle

Interest expense

Operating cash flow before working capital changes

Adjustment for working capital changes

(Increase)/decrease in current assets

(Increase)/decrease in inventories

(Increase)/decrease in trade receivables and prepayments

Increase/(Decrease) in current liabilities

Increase/(decrease) in trade payables

(W-9)

(31,650 - 20,950)

Working capital changes

Cash generated from operations

Less:

Interest paid

(W-3)

Net Cash from operating activities

A

3,570
7,000
(430)
740
3,000
13,880

7,830
2,450
10,700
20,980
34,860

(2,600)
32,260

Cash flow from Investing Activities

Purchase of fixed assets

- Equipment

- Motor vehicle

Sale proceeds from disposal of fixed assets

- Equipment

- Motor vehicle

Purchase of long term investment

Net cash from investing activities

(36,400)

(19,860)

5,630

1,270

(8,000)

(57,360)

B

Cash flow from Financing Activities

Capital introduced

Long term loan repaid

Net cash from financial activities

(W-2)

C

(3,000)

(3,000)

Net increase in cash and cash equivalents

Add: cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period

(A+B+C)

(W-1)

(W-1)

(28,100)

5,400

(22,700)

WORKINGS**(W-1) Cash and cash equivalents**

Cash and Bank

Short term investment

Bank overdraft

2014

2015

700

1,800

4,800

3,600

(28,200)

-

(22,700)

5,400

(W-2)

Loan account

Cash (repaid) (bal.)

3,000

op.

28,000

cl.

25,000

(W-3)

Interest expense

Cash (bal.)

2,600

op.

-

cl.

400

P and L

3,000

(W-4)

Premises at book value

op.

38,000

Depreciation

1,000

cl.

37,000

(W-5)

Equipment at book value

op.

17,600

Depreciation

3,000

Cash (additions) (bal.)

36,400

Disposal - BV

5,200

cl.

45,800

(W-6)

Disposal Account

Equipment at book value

5,200

P and L (bal.)

430

Cash (bal.)

5,630

(W-7)

Motor vehicle at book value

op.

4,080

Depreciation

3,000

Cash (additions) (bal.)

19,860

Disposal

2,010

cl.

18,930

(W-8)

Disposal Account	
Motor vehicle at book value	2,010
	Cash (bal.)
	P and L
	1,270
	740

(W-9) Trade and other payables

Trade payables and accruals

Less: Interest accrued

2015	2014
32,050	20,950
(400)	-
31,650	20,950

Answer-10**Cash flow Direct method****Cash flow from Operating Activities**

Cash received from customers

Less: Cash paid to suppliers

Less: Cash paid to employees and for exp.

Less:

Interest paid

Dividend paid

Net Cash from operating activities

(W-2)

(W-3)

(47,000 - Dep. of 2,000)

(W-10)

A

Rs.

190,000
(110,000)
(45,000)(13,000)
(20,000)
2,000**Cash flow from Investing Activities**

Purchase of fixed assets

- Building

- Plant

Purchase of long term investment

Net cash from investing activities

(W-5)

(W-7)

(80,000 - 50,000)

B

(40,000)
(1,000)
(30,000)
(71,000)**Cash flow from Financing Activities**

Proceeds from issue of share capital

Long term loan raised

Net cash from financial activities

(50,000 - 40,000) + (14,000 - 12,000)

(150,000 - 100,000)

C

12,000
50,000
62,000

Net increase in cash and cash equivalents

Add: cash and cash equivalents at beginning of period (W-1)

Cash and cash equivalents at end of period

(A+B+C)

(W-1)

(7,000)
3,000
(4,000)**WORKINGS**

(W-1) Cash and cash equivalents

Bank

Bank overdraft

2013

2014

3,000

(4,000)

3,000

(4,000)

(W-2)

Debtor account

b/d

Sale

40,000

200,000

Cash (bal.)

c/d

190,000

50,000

(W-3)

Creditors

Cash (bal.)

cl.

110,000

60,000

op.

Purchases (W-3.1)

40,000

130,000

(W-3.1)	op. Purchases (bal.)	Inventory 55,000 130,000	Cost of Sales cl.	120,000 65,000
(W-4)	op. Revaluation Surplus Cash (bal.)	Land at cost 43,000 20,000 -	cl.	63,000
(W-5)	op. Cash (additions) (bal.)	Building at cost 50,000 40,000	Disposal cl.	90,000
(W-6)	cl.	Accumulated depreciation 5,000	op. Depreciation (bal.)	10,000 1,000
(W-7)	op. Cash (additions) (bal.)	Plant at cost 10,000 1,000	cl.	11,000
(W-8)	Disposal (bal.) cl.	Accumulated depreciation 5,000	op. Depreciation (bal.)	4,000 1,000
(W-9)	Dividend (bal.) Closing balance	Accumulated profit account 20,000 25,000	Opening balance Profit	25,000 20,000
(W-10)	Cash (bal.) Closing payable	Dividend Payable account 20,000 20,000	Opening payable Dividend (W-9)	20,000 20,000

Answer-11

Abida Limitd

Cash flow for year ended June 30, 2015

Profit for the year	256,800
Depreciation	17,500
Loss on sale of furniture	6,800
Increase/decrease in working capital	
Decrease in inventories	21,600
Increase in payables	8,900
Increase in receivables	(11,700)
	18,800
	299,900
Add: Proceeds from sale of non-current assets	12,000
	311,900
Less: Purchase of non-current assets (W)	28,900
Payment of long term loan	75,000
Drawings	120,000
	223,900
Net increase in bank balance	88,000

Non-current assets			
Decrease in assets	7,400	Depreciation	17,500
Purchase of assets – balancing figure	28,900	Sale of furniture	12,000
		Loss on above sale	6,800
	<u>36,300</u>		<u>36,300</u>

Answer-12**KLEA's Statement of cash flows for the year ended 31st March 2015**

	Rs. in '000
Cash flows from operating activities	
Profit before taxation	1,606
Adjustments for:	
Depreciation (W4)	800
Finance income	(50)
Interest expense	320
	<u>2,676</u>
Increase in trade receivables	(400)
Increase in inventories	(1,200)
Increase in trade payables	334
Cash generated from operations	<u>1,410</u>
Interest paid	(320)
Income taxes paid (W1)	(630)
Net cash from operating activities	<u>460</u>
Cash flows from investing activities	
Purchase of intangible assets (W2)	(300)
Purchase of property, plant and equipment (W3)	(1,600)
Proceeds from sale of equipment	150
Purchase of long-term investments	(200)
Finance income received	50
Net cash used in investing activities	<u>(1,900)</u>
Cash flows from financing activities	
Proceeds from issue of share capital (1,000 + 278)	1,278
Payments to redeem debentures	(400)
Dividends paid	(400)
Net cash used in financing activities	<u>(400)</u>
Net decrease in cash and cash equivalents	<u>478</u>
Cash and cash equivalents at 1 April 2014	(962)
Cash and cash equivalents at 31 March 2015 (32 - 414)	<u>580</u>
	<u>(382)</u>

(Note: Alternative classifications of the cash flows in accordance with IAS 7 should receive full credit i.e. interest and dividends received as investing activities or operating cash flows, interest and dividends paid as financing or operating cash flows.)

Notes

(1) Analysis of cash and cash equivalents

Cash on hand and balances with bank
Bank overdraft
Cash and cash equivalents

Rs. in '000

2015

2014

32

580

(414)

-

(382)

580

(2)

Material non-cash transactions

During the year land was re-valued upwards by Rs.1million

Workings

(W1) Taxation paid

Taxation creditor brought forward
Taxation expense for period

Rs. in '000

400

650

1,050

Taxation creditor carried forward
Taxation paid in the year

(420)

630

(W2) Intangible assets

Net book value brought forward
Capitalised in the year (from (i))

200

300

500

Amortisation charged in year (from (i))

(200)

Intangibles acquired in the year

300

(W3) Property, plant and equipment

Cost brought forward

3,000

Revaluation in year (from (ii))

1,000

Disposals (from (iii))

(600)

Additions (balancing figure)

1,600

Cost carried forward

5,000

(W4) Depreciation and amortisation

Depreciation (150 movement + 500 on disposal)

650

Amortisation

200

Profit on disposal (W5)

(50)

Charge shown in statement of profit or loss

800

Hence add back of depreciation and amortisation also takes account of the profit on disposal of the plant and machinery.

(W5) Disposal

	Rs. in '000
Cost of disposal	600
Accumulated depreciation	(500)
Net book value	100
Proceeds of sale	150
Profit on sale	50

ICAP MULTIPLE CHOICE QUESTIONS (MCQs)

- Q.1** Faria Limited is involved in the business of furniture. At 1 January 2018 the company's issued share capital consists of 50,000 Rs.1 shares. During the year 2018 company has made a bonus issue of 1 for 5 shares.

What is impact of bonus issue on cash flows of the business?

- (a) Decrease in cash flows from operating activities
- (b) Increase in cash flows from financing activities
- (c) No impact
- (d) Increase in cash generated from operations

- Q.2** A company has incurred a loss of Rs.40,000 during the year 2018; however the balance in the bank account at end of the year is more than the balance at start of the year.

What does this mean?

- (a) Company has allowed a longer credit period to the credit customers
- (b) Company has purchased more stock
- (c) Company has made a right issue during the year
- (d) Company has purchased fixed assets during the year

- Q.3** A company has provided the following information:

	2018	2017
	Rs.	Rs.
Share capital	110,000	100,000
Share premium	30,000	40,000

A bonus issue of 1 for every 10 shares held has been made during the year.

What is the amount to be reported in cash flow from financing activities for the year 2018?

- (a) Rs.10,000 Inflow
- (b) Nil
- (c) Rs.10,000 outflow
- (d) Cannot be determined

- Q.4** A company has provided following balances

	Rs.
Non-current asset - 31 December 2018	125,000
Accumulated depreciation 1 January 2018	25,000
Accumulated depreciation 31 December 2018	38,000

During the year, an asset having cost Rs. 10,000 was sold for Rs. 6,000 and gain on disposal was Rs. 3,000.

What is the charge for depreciation for the year to be adjusted in statement of cash flows?

- (a) Rs 13,000
- (b) Rs.19,000
- (c) Rs.20,000
- (d) Rs.38,000

Q.5 A company has provided following information as at 31 March 2019:

	2019 Rs.	2018 Rs.
Retained earnings	50,000	38,000
Following adjustments were made during the year 2019:		
Dividends paid		Rs. 5,000
Transfer to general reserves		Rs. 12,000
Tax charge		Rs. 4,000

What is the amount of profit before tax for the year 2019 for the purposes of preparing statement of cash flows?

- (a) Rs. 29,000 (b) Rs. 33,000
(c) Rs. 24,000 (d) Rs. 25,000

Q.6 A company has provided the following data:

	Rs.
Receivables at 1 April 2018	12,000
Receivables at 31 March 2019	25,000
Credit sales during the year	75,000
Discount allowed during the year	3,000

What is the amount to be shown as cash received from customers in statement of cash flows using direct method?

- (a) Rs. 62,000 (b) Rs. 75,000
(c) Rs. 59,000 (d) Rs. 65,000

Q.7 Which TWO of the following are considered as inflows in a company's statement of cash flows?

- (a) Bonus shares issued (b) Decrease in accounts receivables
(c) Increase in inventory (d) Increase in accounts payables

Q.8 Which of the following item will appear in cash flows from financing activities section of statement of cash flows?

- (a) Cash paid to acquire non-current assets
(b) Dividends paid
(c) Bonus shares issued
(d) Depreciation for the year

Q.9 Following data is available for a company for the year ended 31 December 2018:

	Rs.
Operating profit before working capital changes	30,000
Increase in accounts receivables	5,000
Increase in inventory	3,000
Increase in accounts payable	2,000
Interest paid	500

What is the net cash generated from cash flows from operating activities for the year ended 31 December 2018?

- (a) Rs. 23,500 (b) Rs. 24,500
(c) Rs. 29,500 (d) Rs. 19,500

CHAPTER-9

- Q.10** Which of the following is an advantage of statement of cash flows?
- It determines the profitability of a business
 - It helps users to estimate the future expected cash flows of the business
 - It determines the ratio of business debts and equity
 - It helps in determining the net assets of a business

- Q.11** A company has made following investments during the year:

6 months Advance rent paid to landlord
 Short term investments bond (highly liquid)
 Debentures purchased- redeemable after 7 years
 Non-current assets purchased

Rs.
 30,000
 25,000
 50,000
 45,000

What is the amount to be shown in investing activities for the year?

- Rs.45,000
- Rs.150,000
- Rs.95,000
- Rs.100,000

- Q.12** A company has provided following data at the end of year 2017:

Share capital Rs. 1 each
 Share premium

Rs.
 100,000
 3,000

The company has made a right issue of 1 for 5 shares during the year 2018 at Rs.1.2 per share.
 What is the amount to be shown in the cash flows from financing activities?

- Rs.24,000 outflow
- Rs.24,000 inflow
- Rs.20,000 inflow
- Rs.4000 inflow

- Q.13** How should gain on sale of used equipment be reported in a cash flow statement, using indirect approach?

- In operating activities as deduction from Profit before tax
- In investing activities as a reduction in cash inflow
- In investing activities as an increase in cash inflows
- In operating activities as addition to profit before tax

- Q.14** Which TWO of the following are added as non cash adjustments to the profit before tax in the cash flow from operating activities section of statement of cash flows?

- Interest expense
- Interest income
- Loss on sale of non-current assets
- Tax charge for the year

- Q.15** Where, in a company's financial statements complying with international accounting standards, should you find the proceeds of non-current assets sold during the period?

- Statement of cash flows and statement of financial position
- Statement of changes in equity and statement of financial position
- Statement of profit or loss and statement of cash flows
- Statement of cash flows only

- Q.16** Zahid & Co. reported a profit Rs. 40,000 for the year, after charging the following:

Depreciation
 Loss on sale of assets

Rs.
 4,000
 3,000

During the year there was a decrease in accounts receivables of Rs. 1,000.

What was the net cash flow generated from operations based on above data?

Rs. _____

Q17 Asmat Limited made a profit for the year of Rs. 320,500, after accounting for depreciation Rs. 32,500. During the year following transactions took place:

Purchase of machinery	Rs.
Increase in accounts receivables	125,000
Increase in inventory	45,000
Increase in accounts payable	28,000
What is the net increase in cash and bank balance during the year?	12,600

Rs. _____

Q18 A company has provided following information:

4% Loan notes	Rs.
Interest payable 1 January 2018	1,000,000
Interest payable 31 December 2018	10,000
What is the amount to be reported as interest paid during the year 2018 in the Statement of Cash Flows?	20,000

Rs. _____

Q19 Furqan Limited has provided following information about non-current assets:

Cost as at 1 January 2018	Rs.
Cost as at 31 December 2018	350,000
During the year an asset costing Rs.100,000 and having net book value of Rs.40,000 was sold at a profit of Rs.30,000.	450,000

What is the net to be shown as outflow in the "Cash flow from investing activities" section in Statement of Cash Flows?

Rs. _____

Q20 The following amounts have been calculated for inclusion in the statement of cash flow of House Limited:

Net cash inflow from financing activities	Rs.
Net cash outflow from investing activities	145,000
Increase in cash and cash equivalents	160,000
Income taxes paid	24,000
Interest paid	65,000
How much cash has been generated from operations?	12,000

Rs. _____

Q21 A cash flow statement provides information that enables users to evaluate the changes in:

- | | |
|-----------------------------|-------------------|
| (a) Solvency | (b) Net assets |
| (c) Its financial structure | (d) Its liquidity |

Q22 Daily sales and purchases and employee costs comprise:

- | | |
|--------------------------|---|
| (a) Operating activities | (b) Investing activities |
| (c) Financing activity | (d) Component of cash and cash equivalent |

CHAPTER-9

- Q.23** Which of the following involves a movement of cash?
- A rights issue
 - Depreciation of fixed assets
 - Creation of a provision for doubtful debts
 - A bonus issue
- Q.24** Activities that result in changes in the size and composition of the equity capital and borrowings of an entity are called:
- Operating activities
 - Investing activities
 - Financing activity
 - None of these
- Q.25** Which of the following are not the operating activities?
- Interest paid
 - Cash payments of income taxes
 - Collections from customers
 - Payment of dividends
- Q.26** Amplifier Limited had sales of Rs.120 million during the year. Trade and other receivables increased from Rs.12 million to Rs.16 million, an increase of Rs.4 million. What amount of cash was received from customers during the year?
- Rs.124 million
 - Rs.116 million
 - Rs.120 million
 - None of these
- Q.27** Cost of sales for Shah Textile Limited during the year was Rs.100 million. Opening inventory was Rs.20 million and closing inventory was Rs.28 million. Opening trade payables were Rs.5 million and closing trade payables were Rs.9 million. What amount of cash was paid to suppliers?
- Rs.102 million
 - Rs.104 million
 - Rs.108 million
 - Rs.110 million
- Q.28** Zaman Limited extracted general ledger from which it shows salaries and wages expense of Rs.50 million during the year. Its cash flow statement reported cash paid to employees of Rs.42 million. The opening balance of accrued salaries and wages was Rs.3.6 million. What was the closing balance for accrued salaries and wages?
- Rs.11.6 million
 - Rs.11.8 million
 - Rs.4.4 million
 - Rs.3.8 million
- Q.29** Gains and losses on disposal of property, plant and equipment are classified as:
- Financing activities
 - Operating activities
 - Investing activities
 - Either financing or operating activities, depending on which method (direct or indirect) is used to determine cash flows from operating activities
- Q.30** Which one of the following events will increase the cash balances of a business?
- Loan repayment to banks
 - Bank granting it an overdraft facility
 - Debtors paying amounts owed
 - Sale of stock on credit
- Q.31** A company with healthy profits is facing a cash shortage. Which of the following events could account for this?
- Delaying payments to creditors
 - The shortening of the credit period granted to debtors
 - The recent acquisition of machinery
 - An increase in dividend proposed by the directors

- Q.32 What is the immediate effect of making a capital repayment on a loan on cash flow and profits?
- On profit - None; On cash - Decrease
 - On profit - Increase; On cash - Decrease
 - On profit - Decrease; On cash - Decrease
 - On profit - Decrease; On cash - None
- Q.33 A company has a negative cash flow from operating activities. What could explain this negative cash flow?
- High levels of dividend payments
 - A substantial investment in new fixed assets
 - A sudden increase in credit sales
 - The repayment of a loan
- Q.34 Which of the following is NOT a cash outflow for the firm?
- Dividends
 - Taxes
 - Interest payments
 - Bad debts
- Q.35 Which of the following would cause negative net cash flow from operating activities?
- Decrease in depreciation expense
 - A substantial investment in fixed assets
 - A significant increase in credit sales
 - Repayment of a long-term loan
- Q.36 Which of the following companies is most likely to face cash flow problems?
- A loss making government organisation
 - A company which has recently sold part of its operations so as to concentrate on its core areas
 - A reasonably profitable and long established company with no expansion plans
 - A profitable retailer about to embark on ambitious expansion plans (Spring 2020) (01)
- Q.37 A debit balance on the retained earnings account indicates that the company has:
- made more dividend payments than the profit earned
 - redeemed some of its share capital
 - accumulated losses
 - issued bonus shares (Spring 2020) (01)
- Q.38 Which of the following would cause negative net cash flow from operating activities?
- Decrease in depreciation expense
 - A substantial investment in fixed assets
 - A significant increase in credit sales
 - Repayment of a long-term loan (Autumn 2020) (01)
- Q.39 In order to survive in the long run, a business must generate positive net cash flow from:
- investing activities
 - operating activities
 - financing activities
 - both (a) and (b) (Spring 2021) (01)

ICAP MULTIPLE CHOICE QUESTIONS (MCQs) SOLUTIONS

- A.1 (c) Bonus issue of shares involves transfer from Reserves to share capital of the company. There is no cash flow involved.
- A.2 (c) The statement indicates that the company had net cash receipts (inflows) despite the losses, which is indicative of receipts of cash by issuing right shares.
- A.3 (b) No cash is paid or received for bonus issue of share capital.

Entry to record bonus issue

	Dr Rs.	CR Rs.
Share premium	10,000	
Share capital		10,000

Share Capital + Share premium

Particular	Rs.	Particular	Rs.
c/d (110,000 + 30,000)	140,000	b/d 100,000+40,000	140,000
	<u>140,000</u>		<u>140,000</u>

- A.4 (c)

Accumulated depreciation

Particulars	Rs.	Particulars	Rs.
Disposal (see below)	7,000	b/d	25,000
c/d	38,000	Depreciation	20,000
	<u>45,000</u>		<u>45,000</u>

Disposal

Particulars	Rs.	Particulars	Rs.
Asset	10,000	Provision for dep. (bal)	7,000
Gain on disposal	3,000	Cash	6,000
	<u>13,000</u>		<u>13,000</u>

- A.5 (b) Profit after tax 29,000 + Tax 4,000 = Rs.33,000 profit before tax

Retained earnings

Particulars	Rs.	Particulars	Rs.
Dividends paid	5,000	b/d	38,000
Transfer to reserves	12,000	Profit for the year	29,000
c/d	50,000		
	<u>67,000</u>		<u>67,000</u>

- A.6 (c)

Accounts receivables

Particulars	Rs.	Particulars	Rs.
b/d	12,000	Cash (bal.)	59,000
Sales	75,000	Discount allowed	3,000
	<u>87,000</u>	c/d	25,000
			<u>87,000</u>

A.7 (b) & (d)

Decrease in accounts receivables indicates that they have paid the debt, hence, inflow for us.

Increase in accounts payable indicates that we have not paid them, thus reducing outflows (or increasing cash flows)

Bonus shares issued do not affect cash flows.

Increase in inventory is cash outflows.

A.8 (b)

Dividend is paid to shareholders who provide finance to the business; therefore, it is treated as financing activity.

Cash paid to acquire non-current assets is shown in investing activities.

Bonus issues have no impact on cash flows of the business.

Depreciation is non-cash item and is adjusted in operating activities.

A.9 (a)

	Rs.	Rs.
Operating profit before working capital changes		30,000
Increase in accounts receivables	(5,000)	
Increase in inventory	(3,000)	
Increase in accounts payable	2,000	(6,000)
Less: Interest paid		(500)
		<u>23,500</u>

A.10 (b)

Users of financial statements may predict future cash flows from past data of how the entity generates and uses its cash.

Profitability is reflected in statement of comprehensive income.

Debt/Equity and net assets are reflected in statement of financial position.

A.11 (c)

Only debentures and non-current assets purchased are included in investing activities; Rs.50,000+45,000= Rs.95,000

Investment in short term bonds will be considered cash equivalent and advance rent would affect operating activities cash flows.

A.12 (b)

Shares issued = $100,000/5 = 20,000$

Cash received = $20,000 \times \text{Rs.}1.2 = \text{Rs.}24,000$

A.13 (a)

The gain on disposal is included in profit before tax as other income. This is deducted back in order to determine the cash figure.

A.14 (a & c)

Interest expense is added back as interest paid is separately reported.

Loss on disposal is added back as this is included in profit before tax as an expense.

Interest income is deducted back.

Tax charge need not be added back as already the amount taken is profit before tax.

A.15 (d)

A.16 Rs. 48,000

	Rs.
Profit before tax	40,000
Adjustments for non-cash items	
Depreciation	4,000
Loss on sale of fixed assets	3,000
Operating profit before working capital changes	47,000
Decrease in accounts receivables	1,000
Cash generated from operations	<u>48,000</u>

A.17 Rs. 167,600

Cash flows from operating activities

Profit before tax	
Depreciation	
Operating profit before working capital changes	
Increase in accounts receivables	
Increase in inventory	
Increase in accounts payable	

Rs.
320,500
32,500
353,000
(45,000)
(28,000)
12,600
292,600

Cash flow from investing activities

Purchase of machinery

(125,000)
167,600

A.18 Rs. 30,000

Interest payable

Particulars	Rs.	Particulars	Rs.
Cash	30,000	b/d	10,000
c/d	20,000	Interest expense	40,000
	50,000		50,000

Interest expense = Rs. 1,000,000 x 4% = Rs. 40,000

A.19 Rs. 130,000

Amounts to be shown in Cash flows from investing activities are;

Cash flows from investing activities	Rs.
Cash paid to acquire assets	(200,000)
Cash received on disposal	70,000
	130,000

Non-current assets

Particulars	Rs.	Particulars	Rs.
b/d	350,000	Disposal	100,000
Cash	200,000	c/d	450,000
	550,000		550,000

Disposal

Particulars	Rs.	Particulars	Rs.
Asset	100,000	Acc. Dep [10,000 - 4,000]	60,000
Gain on disposal	30,000	Cash	70,000
	130,000		130,000

A.20 Rs. 116,000

Cash generated from operations	
Less: Interest paid	
Income taxes paid	
Net cash from operating activities	
Net cash outflow from investing activities	
Net cash inflow from financing activities	
Increase in cash and cash equivalents	

Rs.
116,000
(12,000)
(65,000)
39,000
(160,000)
145,000
24,000

- A.21 (d)
- A.22 (a)
- A.23 (a)
- A.24 (c)
- A.25 (d)
- A.26 (b)
- A.27 (b)
- A.28 (a)
- A.29 (c)
- A.30 (c)
- A.31 (c)
- A.32 (a)
- A.33 (c)
- A.34 (d)
- A.35 (c) A significant increase in credit sales
- A.36 Option d: A profitable retailer about to embark on ambitious expansion plans
- A.37 Option c: Accumulated losses
- A.38 Option c: A significant increase in credit sales
- A.39 (b) Operating activities



Conceptual Framework for Financial Reporting

10

LO 1	THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING
LO 2	QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION
LO 3	RECOGNITION IN THE FINANCIAL STATEMENTS
LO 4	ACCOUNTING CONCEPTS (Revision of Introduction to Accounting)
LO 5	MEASUREMENTS OF ELEMENTS OF FINANCIAL STATEMENTS
LO 6	CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE



LO1: THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

Financial reports are based on estimates, judgements and models rather than exact depictions. The Conceptual Framework establishes the concepts that underlie those estimates, judgements and models.

(a) The purpose of a conceptual framework

- to assist the International Accounting Standards Board (IASB) in the development of future IFRSs and in its review of existing IFRSs;
- to assist the IASB in promoting harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by IFRSs;
- to assist national standard-setting bodies in developing national standards;
- to assist preparers of financial statements in applying IFRSs and in dealing with topics that have yet to form the subject of an IFRS;
- to assist auditors in forming an opinion on whether financial statements comply with IFRSs;
- to assist users of financial statements in interpreting the information contained in financial statements prepared in compliance with IFRSs; and
- to provide those who are interested in the work of the IASB with information about its approach to the formulation of IFRSs.

(b) Contents of conceptual framework

International Accounting Standards Board (IASB) has published "The conceptual framework for financial reporting" which deals with the following chapters, namely:

- Chapter 1 — The Objective Of General Purpose Financial Reporting
- Chapter 2 — Qualitative Characteristics Of Useful Financial Information
- Chapter 3 — Financial Statements And The Reporting Entity
- Chapter 4 — The Elements Of Financial Statements
- Chapter 5 — Recognition And Derecognition Chapter 6 — Measurement
- Chapter 7 — Presentation And Disclosure
- Chapter 8 — Concepts Of Capital And Capital Maintenance

(c) The alternative to a conceptual framework

A system based on detailed rules is an alternative to a system based on a conceptual framework.

(d) Is Conceptual Framework is an IFRS?

The Conceptual Framework is not an IFRS and nothing in the Conceptual Framework overrides any specific IFRS.

On very rare occasions there may be a conflict between the Conceptual Framework and an IFRS. In those cases, the requirements of the IFRS prevail over those of the Conceptual Framework.

LO2: QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION**Information to be useful for decision making**

If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

It means information must have certain characteristics in order for it to be useful for decision making. The *IASB Conceptual Framework* describes:

- fundamental qualitative characteristics; and
- enhancing qualitative characteristics

Fundamental qualitative characteristics

The fundamental qualitative characteristics are

- relevance; and
- faithful representation

Relevance

Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.

The relevance of information is affected by its materiality. Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity.

Faithful representation (True and fair view)

Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the substance of the phenomena that it purports to represent. Although, in many circumstances, the substance of an economic phenomenon and its legal form are the same, an accountant should be careful to identify when this might not be the case.

To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral and free from error. Of course, perfection is seldom, if ever, achievable. The objective is to maximise those qualities to the extent possible.

Enhancing qualitative characteristics

The qualitative characteristics that enhance the usefulness of information that is relevant and a faithful representation are:-

- comparability;
- verifiability
- timeliness; and
- understandability

Comparability

Comparability enables users to identify and understand similarities in, and differences among, items. Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.

Consistency is related to comparability but is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Consistency helps to achieve the goal of comparability.

Verifiability

This quality helps to assure users that information faithfully represents the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus that a particular depiction is a faithful representation. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.

Verification can be direct or indirect.

- Direct verification means verification through direct observation, e.g. by counting cash or inventory.
- Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology. For example, the carrying amount of inventory might be verified by checking the inputs (e.g. costs) and recalculating the closing inventory using the same assumption (e.g. FIFO).

Timeliness

This means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is.

Understandability

Information is made understandable by classifying, characterising and presenting it in a clear and concise manner. Some phenomena are inherently complex and cannot be made easy to understand, however, excluding the relevant information is not justified in such circumstances.

Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently.

Cost constraint on useful information

Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information.

The benefits obtained from financial information should exceed the cost of obtaining and providing it. Information should not be provided if the cost is not worth the benefit.

LO3: RECOGNITION IN THE FINANCIAL STATEMENTS

The element of financial statement (asset, liability, equity, income or expense) should be recognized in the statement of financial position or in the statement of profit or loss when it:

- (a) meets the definition of an element, and also
- (b) satisfies certain criteria for recognition.

Items that fail to meet the criteria for recognition should not be included in the financial statements. However, some of these items may have to be disclosed as additional details in a note to the financial statements.

The criteria for recognition are as follows:

- It must be **probable** that the future economic benefit associated with the item will flow either into or out of the entity.
 - The item should have a cost or value that can be measured reliably.
- (a) **Probability of future economic benefit flowing in or out**
The concept of probability relates to the degree of certainty or uncertainty that the future economic benefit associated with the item will flow into or out of the entity.

The degree of certainty or uncertainty should be assessed on the basis of the evidence available at the time the financial statements are prepared.

(b) **Reliability of measurement**

An item should be recognised in the financial statements only if it has a cost or value that can be measured with reliability.

In many cases, the value of an item has to be estimated because its value is not known with certainty. Using reasonable estimates is an essential part of preparing financial statements, and provided that the estimates are reasonable, it is appropriate to recognise items in the financial statements.

However, if it is not possible to make a reasonable estimate, the item should be excluded from the statement of financial position and statement of profit or loss and other comprehensive income.

An item that cannot be estimated with reliability at one point in time might be estimated with greater certainty at a later time, when it would then be appropriate to include it in the financial statements.

RECOGNITION

(a) **Recognition of assets**

An asset is recognised in the statement of financial position when there is an increase in future economic benefits relating to an increase in an asset (or a reduction in a liability) which can be measured reliably.

An asset should not be recognised when expenses have been incurred but it is unlikely that any future economic benefits will flow to the entity. Instead, the item should be treated as an expense, and the cost of the asset should be written off.

(b) **Recognition of liabilities**

A liability is recognised when it is probable that an outflow of resources that embody economic benefits will result from the settlement of a present obligation, and the amount of the obligation can be measured reliably.

(c) **Recognition of income**

Income is recognised in the statement of profit when an increase in future economic benefits arises from an increase in an asset (or a reduction in a liability) and this can be measured reliably.

(d) **Recognition of expenses**

Expenses are recognised in the statement of profit or loss when a decrease in future economic benefits arises from a decrease in an asset or an increase in a liability, which can be measured reliably.

Note that an expense is recognised at the same time as an increase in a liability (for example, trade payables) or a reduction in an asset (for example, cash).

Expenses are recognised in the statement of profit or loss by means of a direct association between items of income and the expenses incurred in creating that income.

- **Matching of costs and income** involves the simultaneous recognition of revenues and related expenses.
- When economic benefits arise over several accounting periods, and the association with income can only be decided in broad terms, expenses should be recognised in profit and loss (the statement of profit or loss) of

each accounting period on the basis of 'systematic and rational allocation procedures'. For example, depreciation charges for a non-current asset are allocated between accounting periods on a systematic and rational basis, by means of an appropriate depreciation policy and depreciation method.

- When an item of expenditure is not expected to provide any future economic benefits, it should be recognised immediately as an expense in the statement of profit or loss. When the future economic benefits associated with an asset are no longer expected to arise, the value of the asset is written off, and the write-off is treated as an expense.
- An expense may also be recognised when a liability arises without the recognition of any matching asset. For example, a liability might arise when an entity recognises that it will have to make a payment to settle a legal dispute. The cost of the future liability is treated as an expense in the period when the liability is recognised.

104: ACCOUNTING CONCEPTS (Revision of Introduction to Accounting)

(a) Consistency

For the purpose of making the comparison of financial statements easy, the accounting policies and classification of information presented should be consistent over periods.

An entity should retain the presentation and classification of items in the financial statements from one period to the next otherwise there will be a violation of consistency of presentation.

Example

An entity should use consistent accounting policy regarding inventories i.e., either to use FIFO basis or weighted average basis.

(b) Materiality

Information is material if its:

- omission; or
- misstatement will influence the economic decisions of users taken on the basis of the financial statements.

Materiality depends on:

- the size of the item or
- error judged in the particular circumstances of its omission or misstatement.

IAS 1 also states that each material class of similar items should be presented separately in the financial statements.

In addition, items of a dissimilar nature should not be aggregated together in the financial statements (combined as a single item and in a single total), unless their value is immaterial.

Example

In assessing whether or not an item is material, it is not only the amount of the item which needs to be considered. The context is also important:

- If a balance sheet shows non current assets of Rs. 2 million and inventories of Rs. 30,000 an error of Rs. 20,000 in the depreciation calculations might not be regarded as material, however an error of Rs. 20,000 in the inventory valuation will be material.

If a business has a bank loan of Rs. 50,000 and a Rs. 55,000 balance on bank deposit account, it might well be regarded as a material misstatement if these two amounts were displayed on the balance sheet as 'cash at bank Rs. 5,000'. In other words, incorrect presentation may amount to material misstatement even if there is no monetary error.

(c) **Prudence**

Prudence is the inclusion of degree of caution while exercising judgement. Simply, prudence means:

- assets and incomes should not be overstated and
- liabilities or expenses should not be understated

Examples of prudence concept are:

- (i) Creation of provision for doubtful debts by exercising judgement so that assets should not be overstated.
- (ii) Showing stock at net realizable value if cost is greater than NRV.

Example

Where a loss is foreseen, it should be anticipated and taken into account immediately. Even when the amount of the loss is not known, an estimate of the loss should be made. If a business purchases inventory for Rs. 1,200 but, because of a sudden slump in the market, only Rs. 900 is likely to be realized when the inventory is sold; the prudence concept dictates that the inventory must be valued at Rs. 900 i.e. at NRV.

(d) **Matching concept**

It is a concept in which expenses are recorded in way to match them with the revenue earned in a specific period. Depreciation and creation of provision for doubtful debt is example of this.

(e) **Separate entity concept**

It is a concept which dictates that owner is separate person from the business.

(f) **Fair value**

Fair value is the amount for which an asset could be exchanged between:

- knowledgeable
- willing parties
- in an arm's length transaction.

(g) **Offsetting**

IAS 1 states that:

- Assets and liabilities should not be offset against each other.
- Similarly incomes and expenses should not be offset against each other. Instead they should be reported separately.

The exceptions to this rule are when:

- offsetting is required or permitted by an accounting standard or the Interpretation of a standard
- offsetting reflects the economic substance of a transaction. An example specified in IAS 1 is reporting of a gain or loss on disposal of a non-current asset at sale value minus the carrying value of the asset and the related selling expenses.

(a) **Historical Cost**

Assets are recorded at the amount of:

- cash or cash equivalents paid or
- the fair value of the consideration given to acquire them at the time of their acquisition.

Liabilities are measured at:

- the amount of proceeds received in exchange for the obligation (for example, bank loan or a bank overdraft), or
- the amount of cash that will be paid to satisfy the liability.

(b) **Replacement cost/ Current Cost / Current value**

- Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently
- Liabilities are carried at the undiscounted amount currently required to settle them.

(c) **Present value**

Present value is the estimated current value of future amount to be received or paid out.

(d) **Realisable value/settlement value**

- Assets are measured at the amount that could be obtained by selling them.
- Liabilities are measured at the amount that would be required to settle them currently.

This method of measurement is relevant when an entity is not a going concern, and is faced with liquidation (and a forced sale of its assets).

Historical cost is the most commonly used measurement basis. However, the other bases of measurement are often used to modify historical cost. For example, inventories are measured at the lower of cost and net realisable value. Deferred income is measured at present value. Some non-current assets may be valued at current value.

The Framework does not favour one measurement base over the others.

(e) **Fair value**

Fair value is a possible basis for the valuation of assets in the financial statements. Although it is not described in the IASB Conceptual Framework, many IASs and IFRSs require it to be used instead of historical cost or as an alternative to historical cost.

Fair value may be used in financial statements in the following circumstances:

- After its initial recognition at acquisition, a non-current asset may be re-valued to its fair value.
- Inventory is measured in the statement of financial position at the lower of cost or net realisable value. Net realisable value (NRV) is the selling price of the inventory item in the ordinary course of business, less the estimated further costs to completion and the expected selling costs. NRV may or may not be the same as fair value.
- Revenue should be measured in the statement of profit or loss at the fair value of the consideration received or receivable (IFRS 15).

Fair value is often approximately the same as current value, but sometimes fair value and current value can be very different.

Problems with the use of fair value

Fair value is easy to understand and less complicated to apply than value to the business/current value. Arguably, it is also more reliable than value to the business because market value is more easily verified than (for example) economic value. However, it has some serious disadvantages:

- There may not be an active market for some kinds of asset. Where there is no active market, estimates have to be used and these may not be reliable.
- It anticipates sales and profits which may never happen (the entity may have no plans to sell the asset).
- Market values can move up and down quite rapidly. This may distort trends in the financial statements and make it difficult for users to assess an entity's performance over time.

A notable example of this problem occurred during 2007 and 2008 with the collapse of the market for certain types of asset-backed securities (mortgage-related securities known as CDOs). Many banks, particularly in the US and Europe, announced huge losses, largely due to the requirement to write down their investments in these financial instruments to fair value, even though fair value was difficult to assess.

Despite these problems, it looks increasingly likely that the IASB will require greater use of fair value in future.

LO6: CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE

The Conceptual Framework states that there are two concepts of capital:

- A financial concept of capital;
- A physical concept of capital.

Different systems of accounts used different capital maintenance concepts. The choice of capital maintenance has a profound effect on the measurement of profit.

(a) Financial capital maintenance

A financial concept of capital is that the profit is earned during a period if the **financial value** of equity at the end of the period exceeds the financial value of equity at the beginning of the period by adding it except exceed due to raise of capital.

(b) Physical capital maintenance

A physical concept of capital is that the capital of an entity is represented by its **productive capacity or operating capability**. Where a physical concept of capital is used, the main concern of users of the financial statements is with the maintenance of the operating capability of the entity.

With a physical concept of capital maintenance, a profit is not earned during a period unless (excluding new equity capital raised during the period and adding back any distribution of dividends to shareholders) the operating capability of the business is greater at the end of the period than at the beginning of the period.

Consider the basic accounting equation.

$$\text{Assets} = \text{liabilities} + \text{equity}$$

OR

$$\text{Assets} - \text{liabilities} = \text{equity}$$

Whereas Assets – liabilities is also called net asset

Like any other equation, changes on one side of the accounting equation are matched by changes in the other side. Therefore, Profit or loss for a period can be calculated from the difference between the opening and closing net assets after adjusting for any distributions during the period.

Formula of profit are:

$$\text{Change in equity} = \text{Closing equity} - \text{Opening equity}$$

$$\text{Increase in equity} = \text{Profit} + \text{Capital Introduced} - \text{Distributions}$$

$$\text{Profit} = \text{Increase in equity} - \text{Capital Introduced} + \text{Distributions}$$

This shows that the value ascribed to opening equity is crucial in the measurement of profit.

Financial capital maintenance

With the financial concept of capital maintenance, a profit is not earned during a period unless the financial value of equity at the end of the period exceeds the financial value of equity at the beginning of the period (after adjusting for equity capital raised or distributed).

Historical cost accounting is based on the concept of **money financial capital maintenance**. Under this concept, an entity makes a profit when its closing equity exceeds its opening equity measured as the number of units of currency at the start of the period. Note that this is a separate issue from asset valuation. Assets could be revalued during the period but this would have no effect on the opening capital position.

An alternative view of financial capital maintenance is used in constant purchasing power accounting. This system is based on the concept of **real financial capital maintenance**. Under this concept, an entity makes a profit when its closing equity exceeds opening equity remeasured to maintain its purchasing power.

This requires the opening equity to be uplifted by the **general inflation rate**. This is achieved by a simple double entry.

Statement of profit or loss	
Inflation reserve	Debit
	Credit

Physical capital maintenance

A physical concept of capital is that the capital of an entity is represented by its productive capacity or operating capability. Where a physical concept of capital is used, the main concern of users of the financial statements is with the maintenance of the operating capability of the entity.

With a physical concept of capital maintenance, a profit is not earned during a period unless (excluding new equity capital raised during the period and adding back any distribution of dividends to shareholders) the operating capability of the business is greater at the end of the period than at the beginning of the period.

This requires the opening equity to be uplifted by the **specific rates of inflation** that apply to the individual components of the net assets of the company. Again, this is achieved by the same simple double entry.

Example: Capital maintenance concepts

Insari Limited commenced business on 1 January with a single item of inventory which cost Rs.100,000.

During the year it sold the item for Rs.140,000 (cash).

During the year general inflation was 5% but the inflation specific to the item was 10%.

Profit is calculated under each concept in the following ways.

	Capital maintenance concept		
	Financial (money terms)	Financial (real terms)	Physical
	Rs.	Rs.	Rs.
Statement of profit or loss			
Revenue	140,000	140,000	140,000
Cost of sale	(100,000)	(100,000)	(100,000)
Inflation adjustment (inflation rate applied to opening equity):		(5,000)	
5% × Rs.100,000			(10,000)
10% × Rs.100,000			30,000
	40,000	35,000	
Statement of financial position			
Total assets	Rs. 140,000	Rs. 140,000	Rs. 140,000
Equity and liabilities:			
Opening equity	100,000	100,000	100,000
Inflation reserve (See above)		5,000	10,000
	100,000	105,000	110,000
Retained profit (Profit for the year)	40,000	35,000	30,000
	140,000	140,000	140,000

Commentary on the example

Under historical cost accounting, the profit is Rs.40,000. If the business paid this out as a dividend it would have Rs.100,000 left.

Rs.100,000 is the opening equity expressed as a number of units of currency. This means that the company would have maintained its equity expressed as a number of units of currency. However, inflation in the period has caused the purchasing power of the currency to decline. This means that Rs.100,000 no longer has the same purchasing power that it had a year ago. The company has not maintained its capital in real terms.

To maintain its opening equity in real terms the company would have to ensure that it had the same purchasing power at the year-end as it had at the start. **General Inflation** was 5% so the company would need Rs.105,000 at the year-end in order to have the same purchasing power as it had at the start of the year. The company can achieve this by transferring Rs.5,000 from profit and loss into an inflation reserve. Profit would then be reported as Rs.35,000.

If the business paid out Rs.35,000 as a dividend it would have Rs.105,000 left. This is not enough to buy the same asset that it had at the start of the year. The asset has been subject to **specific inflation of 10%** therefore the company would need Rs.110,000 at the year-end in order to buy the same asset.

This means that the company would not have the same capacity to operate as it had a year ago.

To maintain its opening equity in physical terms the company would have to ensure that it had the same ability to operate at the year-end as it had at the start. In other words it would need to have Rs.110,000. The company can achieve this by transferring Rs.10,000 from profit and loss into an inflation reserve. Profit would then be reported as Rs.30,000.

Comparing the two concepts

Neither the IASB Conceptual Framework nor accounting standards require the use of a specific capital maintenance concept. In practice, almost all entities use money financial capital maintenance, but both concepts can provide useful information.

Financial capital maintenance is likely to be the most relevant to investors as they are interested in maximising the return on their investment and therefore its purchasing power.

Physical capital maintenance is likely to be most relevant to management and employees as they are interested in assessing an entity's ability to maintain its operating capacity. This is particularly true for manufacturing businesses, where management may need information about the ability of the business to continue to produce the same or a greater volume of goods.

ICAP PAST PAPER QUESTIONS**QUESTION-1**

- (a) What does a complete set of financial statements comprises of?
 (b) Explain the following accounting terms:
 (i) Net realizable value
 (ii) Fair value

(05)

(04)

{Spring 2014, Q # 1}

QUESTION-2

- (a) Briefly describe any four measurement bases that may be used to measure the value of assets in the financial statements.
 (b) For measuring the value of a motor vehicle in the financial statements, a company is considering the following alternatives:
 (i) Value the motor vehicle at Rs.864,000 based on the sale price of a similar motor vehicle if sold today;
 (ii) Value the motor vehicle at Rs.1,235,000 based on the cost of the motor vehicle when purchased two years ago;
 (iii) Value the motor vehicle at Rs.1,481,000 based on the cost of a similar motor vehicle if purchased today;
 (iv) Value the motor vehicle at Rs.800,000 at which price a motor vehicle dealer is willing to purchase.

(06)

Required:

Identify the basis of measurement of the motor vehicle in each of the above cases.

(04)

{Autumn 2013, Q#1}

QUESTION-3

List the components of a complete set of financial statements.

(03)

{Spring 2012, Q # 1}

QUESTION-4

What is the most commonly adopted basis of measurement? Give two examples where two different basis of measurement are used in combination, to measure an asset or liability.

(03)

{Autumn 2011, Q # 1}

QUESTION-5

Briefly describe the measurement bases that may be used to measure the value of assets in the financial statements.

(06)

{Spring 2020 Q.3}

ICAP PAST PAPER SOLUTIONSAnswer-1

- (a) A complete set of financial statements comprises:
- (i) a statement of financial position as at the end of the period (balance sheet);
 - (ii) a statement of comprehensive income for the period (profit and loss a/c income statement);
 - (iii) a statement of changes in equity for the period;
 - (iv) a statement of cash flows for the period;
 - (v) notes to the accounts;
- (b) (i) **Net realisable value** is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.
- (ii) **Fair value** is the amount for which an asset could be exchanged between:
- knowledgeable
 - willing parties
 - in an arm's length transaction.

Answer-2

- (a) (i) **Historical Cost**
Assets are recorded at the amount of:
- cash or cash equivalents paid or
 - the fair value of the consideration given to acquire them at the time of their acquisition.
- (ii) **Replacement cost/ Current Cost**
Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently
Liabilities are carried at the undiscounted amount currently required to settle them.
- (iii) **Present value**
Present value is the estimated current value of future amount to be received or paid out.
- (iv) **Realisable value/settlement value**
It is value of an asset at which it can be sold today.
- (b) (i) Realisable (settlement) value
- (ii) Historical cost
- (iii) Replacement cost (Current cost)
- (iv) Fair value

Answer-3Components of Financial Statements

- A complete set of financial statements comprises:
- (i) a statement of financial position as at the end of the period;
 - (ii) a statement of comprehensive income for the period;
 - (iii) a statement of changes in equity for the period;
 - (iv) a statement of cash flows for the period;
 - (v) notes to the accounts;

Answer-4

The commonly adopted basis of measurement is historical cost. An inventory is carried at lower of cost or NRV. Fixed assets may be carried at historical cost or revalued amount.

Answer-5**(i) Historical cost**

The historical cost of an asset, when it is acquired or created is the value of the cost incurred in acquiring or creating the asset, comprising the consideration paid to acquire or create the asset plus transaction cost.

(ii) Current value

Current value measures provide monetary information about assets using information updated to reflect conditions at the measurement date.

Current value measurement bases include:

- Fair value
- Value in use for assets
- Current cost

Fair value

Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Fair value reflects the perspective of market participants.

Value in use

Value in use is the present value of the cash flows or other economic benefit that an entity expects to derive from the use of an asset and from its ultimate disposal. Value in use reflect entity specific assumptions rather than assumptions by market participants.

Current cost

The current cost of an asset is the cost of an equivalent asset at the measurement date comprising the consideration that would be paid at the measurement date plus the transaction cost that would be incurred at that date.

Current cost, like historical cost is an entry value; while fair value is an exit value. However, unlike historical cost, current cost reflects conditions at the measurement date.

ICAP QUESTIONS BANK QUESTIONS**QUESTION-1**

What is the criteria for recognition of assets and which of the following assets will be recognized in the financial statements of a company in accordance with the criteria?

- A manufacturing unit valuing Rs.5 million, owned and controlled by the Company
- A fleet of trucks valuing Rs.100 million, controlled by another company
- A highly skilled workforce, getting an annual compensation of Rs.12.5 million

(ICAP Example 1)

QUESTION-2

ABC received Rs. 160,000 in cash on 20 December 2004 from RM in return for having provided financial advice during the 2004 financial year.

Required:

- (a) Explain, with reference to the relevant definitions, which elements should possibly be recognized in the 2004 financial year.
- (b) Briefly identify whether and/ or how your answer would change if the cash received had been received for financial advice to be provided in the 2005 financial year.

(ICAP Example 2)

QUESTION-3

Read the following scenarios:

1. An amount paid to landlord totalling Rs.120,000 on 1st January 2012 against the rent for the year ended 31st December 2012. Year end of the entity is 30 June 2012.
2. An expenditure incurred on repairs and maintenance of plant amounting Rs.300,000.
3. There has been legal dispute between the entity and its customer and company expects the outflow of Rs. 200,000 in order to settle the dispute.
4. Entity purchased goods costing Rs. 20,000 for trading purposes and the same was sold for Rs. 25,000.

Required:

Which of the above, would be recognized as expense &/or asset in the financial statements of a company in accordance with the criteria given in conceptual framework.

(ICAP Example 3)

QUESTION-4

Adeel Limited (AL) owns a machine which it purchased two years ago for Rs. 200,000. The accumulated depreciation on the machine to date is Rs. 80,000 based on 5 years life using straight line method.

The machine could be sold in the market for Rs. 100,000 but there would be dismantling costs of Rs. 10,000.

The cash flows from the existing machine are estimated to be Rs. 50,000 for the next two years followed by Rs. 40,000 in the last year. Relevant discount rate is 10%.

To replace the machine with a new version would cost Rs. 220,000.

Required:

Measure the machine using different measurement bases for AL using the above information.

(ICAP Example 5)

QUESTION-5

Briefly describe the measurement bases that may be used to measure the value of assets in the financial statements.

(ICAP Example 6)

QUESTION-6

A factory building was purchased from Habib Factory by a company for Rs.100 million in 2009. Its useful life was estimated to be 25 years. The building was revalued in 2019 at Rs.75 million. It was decided to sell the factory building at Rs.90 million after incurring repairs and painting work done of Rs.10 million.

What will be the cost of the asset under each of the following measurement basis:

- Historical cost
- Current cost
- Realizable(settlement) value

QUESTION-7

Carrie starts in business on 1 January Year 1. Carrie's sole shareholder contributed capital of Rs.1,000. Carrie purchased one item of inventory for Rs.1,000 and sold that inventory for cash of Rs.1,400. At the end of Year 1 the replacement cost of the same item of inventory is Rs.1,100. General inflation during the year was 7%.

Required

Calculate the profit for the year and set out a summary statement of financial position as of 31 December Year 1 under the following capital maintenance concepts.

- (a) Physical capital maintenance
- (b) Financial capital maintenance
 - (i) Historical cost accounting
 - (ii) Constant purchasing power accounting

(ICAP Example 7)

QUESTION-8

Mark true/false against each given scenario and give reasons for the selected answer:

- A. In case of conflict between requirements of conceptual framework and IFRS, the requirements of conceptual framework shall prevail.
- B. Conceptual framework is not an International financial reporting standard (IFRS)
- C. HR related cost is recognized as an asset in the financial statements since economic benefit is probable from human resource
- D. Internally generated goodwill is recognized as asset and measured at fair value in the financial statements
- E. When economic benefits arise over several accounting periods, and the association with income can only be decided in broad terms, expenses should be recognized in profit and loss of each accounting period on the basis of systematic and rational allocation procedure
- F. When an item of expenditure is not expected to provide any future economic benefit, it is recognized as an asset in the financial statements
- G. In fair value method, assets are measured at the amount that would be paid to purchase the same or a similar asset currently.

(ICAP Example 8)

QUESTION-9

Which of the following, would be recognized as income &/or liability in the financial statements of a company in accordance with the criteria given in conceptual framework:

1. Advance received from customer amounting Rs.50,000 against the goods to be delivered after 6 months
2. Services provided to ABC and Co. on credit amounting Rs.30,000.
3. Account Receivables already written off in previous years amounting Rs.30,000 were received during the year.

(ICAP Example 4)

ICAP QUESTIONS BANK SOLUTIONS**Answer-1**

An entity can recognize assets in its balance sheet only if the following conditions are met:

- It is probable that any future economic benefits associated with the asset will flow to or from the entity
 - The cost/value of the asset can be measured reliably
- The following will be recognized in the financial statements:

- A manufacturing unit valuing Rs.5 million, owned and controlled by the Company
- The fleet of truck will not be recognized because it is not controlled by the entity. Similarly, workforce will not be recognized by the entity because there is no certainty about the probability of future economic benefits from workers as they can quit the entity at any time.

Answer-2**Part (a)**

The cash received meets the definition of an asset i.e. present resource now controlled by the entity and entity may spend it as it may wish. Services have already been provided, therefore, there is no obligation (no change in liability). Increase in equity shall be recognised as an income.

An asset and an income shall be recognised in year 2004.

Part (b)

The cash received meets the definition of an asset i.e. present resource now controlled by the entity and entity may spend it as it may wish. Services have not been provided and there is present obligation to provide services, resulting in increase in liability. No income can be recognised as there is no equity increase.

An asset and a liability shall be recognised in year 2004.

Answer-3

1. Increase in asset (advance rent: Future benefits) Rs. 60,000 and decrease in asset (Cash) Rs. 120,000 resulting in net decrease in equity is Rent expense (Rs. 60,000).
2. Decrease in asset (Cash) Rs. 300,000 and no increase in other assets (unless increase in present resources) resulting in net decrease in equity is Repair expense (Rs. 300,000).
3. Increase in liability (obligation to settle) Rs. 200,000 and no increase in any assets resulting in net decrease in equity is Expense (Rs. 200,000).

Answer-4**Historical cost**

Cost
Less: Accumulated depreciation

Rs.
200,000
(80,000)
<u>120,000</u>

Fair value

The fair value is market value (exit price) of Rs. 100,000 without deducting cost to sell of Rs. 10,000.

Value in use

Year 1
Year 2
Year 3

Rs. 50,000 x 1.1⁻¹
Rs. 50,000 x 1.1⁻²
Rs. 40,000 x 1.1⁻³

Rs.
45,455
41,322
30,053
<u>116,830</u>

Current cost

Cost of new asset

Less: Accumulated depreciation*

Rs. 220,000 / 5 x 2 years

Rs.
220,000
(88,000)
132,000

*The replacement cost is of new machine and needs to be adjusted for two years usage.

Answer-5**(i) Historical cost**

The historical cost of an asset, when it is acquired or created is the value of the cost incurred in acquiring or creating the asset, comprising the consideration paid to acquire or create the asset plus transaction cost.

(ii) Current value

- Current value measures provide monetary information about assets using information updated to reflect conditions at the measurement date.
- Current value measurement bases include:
 - Fair value
 - Value in use for assets
 - Current cost

(iii) Fair value

Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Fair value reflects the perspective of market participants.

(iv) Value in use

Value in use is the present value of the cash flows or other economic benefit that an entity expects to derive from the use of an asset and from its ultimate disposal. Value in use reflect entity specific assumptions rather than assumptions by market participants.

(v) Current cost

The current cost of an asset is the cost of an equivalent asset at the measurement date comprising the consideration that would be paid at the measurement date plus the transaction cost that would be incurred at that date.

Current cost, like historical cost is an entry value; while fair value is an exit value. However, unlike historical cost, current cost reflects conditions at the measurement date.

Answer-6

The cost of the asset under each measurement basis shall be as follows:

Historical cost

The historical cost of the building is Rs.100 million.

Current cost

The current cost of the building shall be its revalued amount which is Rs.75 million.

Realizable(settlement) value

The realizable value of the building will be its selling cost less any costs incurred to sell the asset, which is 90 million less 10 million, i.e, Rs.80 million.

When purchased inventory, it was a present economic resource and recognised as an asset. When sold, it becomes expense (cost of sales) due to decrease in assets resulting in decrease in equity.

Answer-7

	(a) Physical Capital Maintenance	(b) Financial Capital Maintenance	
		(i) Historical cost accounting	(ii) Constant purchasing power accounting
	Rs.	Rs.	Rs.
Profit for the year	1,400	1,400	1,400
Sales	(1,000)	(1,000)	(1,000)
Cost of sales			
Inflation adjustment	(100)	-	-
- Specific (1,100 - 1,000)			
- General (1,000 × 7%)	-	-	(70)
Profit	<u>300</u>	<u>400</u>	<u>330</u>
Balance sheet as at 31 December Year 1			
Cash at bank	1,400	1,400	1,400
Share capital (1,000 + 100) (1,000 + 70)	1,100*	1,000	1,070*
Reserves	<u>300</u>	<u>400</u>	<u>330</u>
	<u>1,400</u>	<u>1,400</u>	<u>1,400</u>

Tutorial note

Share capital at the year end is restated under the physical capital maintenance concept for an increase in specific price changes and under Constant Purchasing Power accounting for general price changes. This is the other side of the entry to the inflation adjustments in the statement of profit or loss

Answer-8

- False. In case of conflict between requirements of conceptual framework and IFRS, the requirements of IFRS shall prevail being an established principle that specific law requirements prevail over general law requirements
- True. Conceptual framework provides foundation for the IFRSs
- False. HR related cost can never be capitalized as it does not meet the definition criteria of asset "controlled by the entity"
- False. Internally generated goodwill can never be recognized as it does not meet one of the basic recognition criteria i.e. "The item should have a cost or value that can be measured reliably"
- True, because of matching principle
- False. For any item to be recognized as an asset, it must be probable that an item shall provide future economic benefits to the entity.
- False. In current cost method assets are measured at the amount that would be paid to purchase the same or a similar asset currently

Answer-9

- Advance from customer amounting to Rs.50,000 – Liability
- Accounts receivable amounting to Rs.30,000- Income
- Reversal of bad debts amounting to Rs.30,000-Income

ICAP MULTIPLE CHOICE QUESTIONS (MCQs)

- Q.1** Which of the following measurement bases are referred to in the Board's Conceptual Framework?
- Current Cost, Residual Value, Fair Value, Present Value
 - Current Cost, Historical Cost, Fair Value, Present Value
 - Current Cost, Fair Value, Present Value, Future Value
 - Fair Value, Present Value, Future value, Residual Value
- Q.2** Financial capital maintenance (money terms) is also referred to as:
- Historical cost accounting
 - Current cost accounting
 - Constant purchasing power accounting
 - Fair value accounting
- Q.3** Which of the following concepts measures profit in terms of an increase in the productive capacity of an entity?
- Physical capital maintenance
 - Historical cost accounting
 - Financial capital maintenance
 - Going concern concept
- Q.4** Which of the following statements is true about historical cost accounts in times of rising prices?
- Profits will be overstated, and assets will be understated
 - Asset values will be overstated
 - Unrecognised gains will be recorded incorrectly
 - Depreciation will be overstated
- Q.5** Which of the following criteria need to be satisfied in order for an element to be recognised within the financial statements?
- It meets the definition of an element of the financial statements.
 - It is probable that future economic benefits will flow to or from the entity.
 - It is certain that future economic benefits will flow to or from the entity.
 - The item has a cost or value.
 - The item has a cost or value that can be reliably measured.
- (i), (ii) and (v)
 - (i), (iii) and (v)
 - (i), (ii) and (iv)
 - (i), (iii) and (iv)
- Q.6** Which of the following is NOT a purpose of the International Accounting Standards Board's Conceptual Framework?
- To assist the Board in the preparation and review of IFRS Standards.
 - To assist auditors in forming an opinion on whether financial statements comply with IFRS Standards.
 - To assist in determining the treatment of items not covered by an existing IFRS Standards.
 - To be authoritative where a specific IFRS Standard conflicts with the Conceptual Framework.

- Q.7 Which of the following items should be recognised as an asset in the statement of financial position of an entity?
- (a) A skilled and efficient workforce which has been very expensive to train. Some of these staff are still employed by the entity.
 - (b) A highly lucrative contract signed during the year which is due to commence shortly after the year-end.
 - (c) A government grant relating to the purchase of an item of plant several years ago which has a remaining life of four years.
 - (d) A receivable from a customer which has been sold (factored) to a finance company. The finance company has full recourse to the entity for any losses.
- Q.8 Which of the following criticisms does NOT apply to historical cost financial statements during a period of rising prices?
- (a) They contain mixed values, some items are at current values, some at out-of-date values
 - (b) They are difficult to verify as transactions could have happened many years ago
 - (c) They understate assets and overstate profit
 - (d) They overstate gearing in the statement of financial position
- Q.9 Financial capital maintenance (real terms) is also referred to as:
- (a) Historical cost accounting
 - (b) Current cost accounting
 - (c) Constant purchasing power accounting
 - (d) Fair value accounting
- Q.10 Physical capital maintenance is also referred to as:
- (a) Historical cost accounting
 - (b) Current cost accounting
 - (c) Constant purchasing power accounting
 - (d) Fair value accounting
- Q.11 In which of the following, no adjustment for inflation is considered?
- (a) Financial capital maintenance (money terms)
 - (b) Financial capital maintenance (real terms)
 - (c) Physical capital maintenance
 - (d) Fair value accounting
- Q.12 In which of the following, inflation adjustment is made on general rate of inflation?
- (a) Financial capital maintenance (money terms)
 - (b) Financial capital maintenance (real terms)
 - (c) Physical capital maintenance
 - (d) Fair value accounting
- Q.13 In which of the following, inflation adjustment is made on specific rate of inflation?
- (a) Financial capital maintenance (money terms)
 - (b) Financial capital maintenance (real terms)
 - (c) Physical capital maintenance
 - (d) Fair value accounting
- Q.14 Financial capital maintenance is likely to be most relevant to:
- (a) Investors
 - (b) Management and employees
 - (c) Neither (a) nor (b)
 - (d) Capital maintenance is always irrelevant to decision making

- Q.15** Physical capital maintenance is likely to be most relevant to:
- (a) Investors
 - (b) Management and employees
 - (c) Neither (a) nor (b)
 - (d) Capital maintenance is always irrelevant to decision making
- Q.16** An entity made a profit of Rs. 350,000 for the year 2019 based on historical cost accounting principles. It had opening capital of Rs. 1,000,000.
Specific price indices increase during the year by 20% and general price indices by 5%.
How much profit should be recorded for 2019 under money financial capital maintenance concept?
Rs. _____
- Q.17** An entity made a profit of Rs. 350,000 for the year 2019 based on historical cost accounting principles. It had opening capital of Rs. 1,000,000.
Specific price indices increase during the year by 20% and general price indices by 5%.
How much profit should be recorded for 2019 under real financial capital maintenance concept?
Rs. _____
- Q.18** An entity made a profit of Rs. 350,000 for the year 2019 based on historical cost accounting principles. It had opening capital of Rs. 1,000,000.
Specific price indices increase during the year by 20% and general price indices by 5%.
How much profit should be recorded for 2019 under physical capital maintenance concept?
Rs. _____
- Q.19** An entity acquired an item of plant on 1 October 2012 at a cost of Rs.500,000. It is being depreciated over five years, using straight-line depreciation and an estimated residual value of 10% of its historical cost or current cost as appropriate. As at 30 September 2014, the manufacturer of the plant still makes the same item of plant and its current price is Rs.600,000.
What is the correct carrying amount to be shown in the statement of financial position as at 30 September 2014 under historical cost accounting?
Rs. _____
- Q.20** An entity acquired an item of plant on 1 October 2012 at a cost of Rs.500,000. It is being depreciated over five years, using straight-line depreciation and an estimated residual value of 10% of its historical cost or current cost as appropriate. As at 30 September 2014, the manufacturer of the plant still makes the same item of plant and its current price is Rs.600,000.
What is the correct carrying amount to be shown in the statement of financial position as at 30 September 2014 under current cost accounting?
Rs. _____
- Q.21** An entity made a profit of Rs. 480,000 for the year 2018 based on historical cost accounting principles. It had opening capital of Rs. 1,100,000. During 2018, specific price indices increased by 15% while general price indices increased by 12%. How much profit should be recorded for 2018 under real financial capital maintenance concept?
- (a) Rs. 480,000
 - (b) Rs. 315,000
 - (c) Rs. 348,000
 - (d) Rs. 645,000

Q22 Which of the following statements is correct about financial statements based on historical cost in times of rising prices?

- (a) Profits will be overstated and assets will be understated
- (b) Assets will be overstated
- (c) Profits as well as assets will be understated
- (d) Depreciation will be overstated

Q23 The IASB's Framework identifies qualitative characteristics.

- (i) Relevance
- (ii) Comparability
- (iii) Verifiability
- (iv) Understandability
- (v) Faithful representation.

Which of the above are not listed as enhancing characteristics?

- (a) (i), (iv) and (v)
- (b) (ii), (iii) and (iv)
- (c) (ii) and (iii)
- (d) (i) and (v)

Q24 The IASB's Conceptual Framework for Financial Reporting identifies qualitative characteristics of financial statements.

Which TWO of the following characteristics are NOT fundamental qualitative characteristics according to the IASB's The Conceptual Framework for Financial Reporting?

- (a) Relevance
- (b) Reliability
- (c) Faithful representation
- (d) Comparability

Q25 An entity made a profit of Rs.480,000 for the year 2018 based on historical cost accounting principles. It had opening capital of Rs.1,100,000. During 2018, specific price indices increased by 15% while general price indices increased by 12%. How much profit should be recorded for 2018 under real financial capital maintenance concept?

- (a) Rs.480,000
- (b) Rs.315,000
- (c) Rs.348,000
- (d) Rs.645,000

(01)

[Autumn-2019]

Q26 Which of the following statements is correct about financial statements based on historical cost in times of rising prices?

- (a) Profits will be overstated and assets will be understated
- (b) Assets will be overstated
- (c) Profits as well as assets will be understated
- (d) Depreciation will be overstated

(01)

[Autumn-2020]

Q27 Which of the following is NOT a measurement base for assets as referred in the Conceptual Framework?

- (a) Value in use
- (b) Fulfilment value
- (c) Current cost
- (d) Fair value

(01)

[Spring-2021]

Q28 An entity made a profit of Rs. 550,000 for the year 2020 based on historical cost accounting principles. It had opening capital of Rs. 1,500,000. During 2020, specific prices indices increased by 15% while general price indices increased by 10%. How much profit should be recorded for 2020 under physical capital maintenance concept?

- (a) Rs. 325,000
- (b) Rs. 400,000
- (c) Rs. 467,500
- (d) Rs. 495,000

(01)

[Spring-2021]

ICAP MULTIPLE CHOICE QUESTIONS (MCQs) SOLUTIONS

- A.1 (b)
- A.2 (a)
- A.3 (a) Physical capital maintenance looks at profit in terms of the physical productive capacity of the business, taking into account specific price changes relevant to the entity.
- A.4 (a) In times of rising prices, asset values will be understated, as historical cost will not be a true representation of the asset values. Additionally, the real purchase cost of replacement items will not be incorporated, meaning that profits are overstated.
- A.5 (a) There only has to be probable flow of economic benefits, rather than a certain flow. Also, the cost or value must be capable of reliable measurement, or no amount can be put into the financial statements.
- A.6 (d) Where there is conflict between the conceptual framework and an IFRS Standard, the IFRS Standard will prevail. An example of this is IAS 20 Government grants, where deferred grant income is held as a liability, despite not satisfying the definition of a liability.
- A.7 (d) As the receivable is 'sold' with recourse it must remain as an asset on the statement of financial position and is not derecognised.
- A.8 (b) Historical cost is the easiest to verify as the cost can be proved back to the original transaction. Fair value is often more difficult to verify as it may involve elements of estimation.
- A.9 (c)
- A.10 (b)
- A.11 (a)
- A.12 (b)
- A.13 (c)
- A.14 (a)
- A.15 (b)
- A.16. Rs.350,000.
 Money financial capital maintenance looks at the actual physical cash. No inflation adjustment is required.
- A.17 Rs.300,000.
 $\text{Rs.350,000} - (1,000,000 \times 5\%) = \text{Rs.300,000}$
- A.18 Rs.150,000.
 $\text{Rs.350,000} - (1,000,000 \times 20\%) = \text{Rs.150,000}$
- A.19 Rs.320,000
 Historical cost annual depreciation = Rs.90,000 $[(500,000 \times 90\%) / 5 \text{ years}]$. After two years carrying amount would be Rs.320,000 = $[(500,000 - (2 \times 90,000))]$.
- A.20 Rs.384,000
 Current cost annual depreciation = Rs.108,000 $[(600,000 \times 90\%) / 5 \text{ years}]$. After two years carrying amount would be Rs.384,000 = $[(600,000 - (2 \times 108,000))]$.

- A.21 (c) Rs. 348,000
- A.22 (a) Profits will be overstated and assets will be understated.
- A.23 (d) Relevance and faithful representation are fundamental characteristics. Without these characteristics, information cannot be useful.
- A.24 (b) & (d) It is important to learn that the two fundamental characteristics are relevance and faithful representation.
- A.25 (c) Rs. 348,000 ($480,000 - 1,100,000 \times 12\%$)
- A.26 Option a: Profits will be overstated and assets will be understated.
- A.27 (b) Fulfilment value
- A.28 (a) Rs. 325,000



Interpretation of Financial Statements

11

LO 1	INTERPRETATION OF FINANCIAL STATEMENTS WITH FINANCIAL RATIOS
LO 2	FINANCIAL STATEMENTS ANALYSIS
LO 3	LIMITATIONS OF RATIO ANALYSIS



Interpretation of Financial Statements

LO 1: INTERPRETATION OF FINANCIAL STATEMENTS WITH FINANCIAL RATIOS:

Financial ratio analysis helps a business in a number of ways. The importance and advantages of financial ratios are given below:

- Ratios help in analysing the performance trends over a long period of time.
- They also help a business to compare the financial results to those of competitors.
- Ratios assist the management in decision making.
- They also point out problem and weak areas along with the strength areas.
- Ratios help to develop relationships between different financial statement items.
- Ratios have the advantage of controlling for differences in size. For example, two businesses may be quite different in size but can be compared in terms of profitability, liquidity, etc., by the use of ratios.

Categories of financial ratios:

Profitability ratios: 1-8	1.	Return on capital employed (ROCE)
	2.	Return on ordinary shareholder capital/Return on equity
	3.	Return on assets
	4.	Net profit/sales ratio
	5.	Gross profit/sales ratio
	6.	Cost of sales/sales ratio, admin expense/ sales ratio, selling expense/sales ratio
	7.	Sales/capital employed ratio or asset turnover ratio
	8.	Percentage annual growth in sales
Working capital efficiency ratios (working capital turnover ratios): 9-15	9.	Debtor turnover days
	10.	Inventory turnover days
	11.	Creditor turnover days
	12.	Cash operating cycle/working capital cycle
	13.	Debtor/receivable turnover
	14.	Stock turnover
	15.	Creditor/payable turnover
Liquidity ratios: 16-17	16.	Current ratios
	17.	Quick ratio/acid test ratio
Debt ratio: 18	18.	Gearing/leverage ratio
	19.	Interest Cover ratio

Users and their needs:

User / stakeholder	Ratio in which user is interested
Private investor	Profitability ratios
Potential acquirer	Profitability ratios and working capital efficiency ratios
Bank or potential lender who is providing loan	Liquidity ratios and gearing ratios

Question-1

X Limited is a ceramics company, which has hired you to assess its performance and for this purpose it has obtained the draft financial statements of another company named Y Limited working in the same industry. The financial statements of each of the companies are as follows:

Income statements for the year ended 31 March 2013

	X Limited Rs.000	Y Limited Rs.000
Revenue	12,000	12,000
Cost of sales	(9,330)	(9,330)
Gross profit	2,670	2,670
Administrative expenses	(920)	(920)
Distribution costs	(490)	(490)
Finance cost	(510)	(510)
Profit before tax	750	750
Income tax	(150)	(150)
Profit after tax	600	600

Statements of financial position as at 31, March

	2013 X Limited Rs.000	2012 X Limited Rs.000	2013 Y Limited Rs.000	2012 Y Limited Rs.000
Assets				
Non-current assets				
Plant and machinery	5,000	8,600	8,800	9,200
	5,000	8,600	8,800	9,200
Current assets				
Inventories	4,200	1,600	1,500	1,200
Trade receivables	2,400	1,900	1,900	1,100
Bank and cash	2,300	400	2,200	1,000
	8,900	3,900	5,600	3,300
Total assets	13,900	12,500	14,400	12,500

Equity and liabilities**Equity**

Equity shares of Rs.1 each
Share premium
Retained earnings

2,000	2,000	2,500	2,000
1,900	2,100	1,200	1,700
3,200	2,200	2,000	1,500
7,100	6,300	5,700	5,200

Non-current liabilities**Loan**

3,000	2,000	4,000	2,500
3,000	2,000	4,000	2,500

Current liabilities

Trade payables
Taxation

3,200	1,800	1,600	1,600
600	2,400	3,100	3,200
3,800	4,200	4,700	4,800
13,900	12,500	14,400	12,500

Total equity and liabilities

Required:

Calculate the following ratios for both companies and comment on the ratios:

1. Return on capital employed (ROCE)
2. Return on equity
3. Return on assets/investments
7. Sales / capital employed ratio
9. Debtor turnover days
10. Inventory turnover days
11. Creditors turnover days
12. Business/Cash cycle
13. Debtor turnover
14. Inventory/ Stock turnover
15. Creditor turnover
16. Current ratio
17. Quick ratio
18. Gearing ratio

Question- 2

Income statements for the year ended 31 Dec 2016

	A Limited Rs.000	B Limited Rs.000
Revenue	1,000	2000
Cost of sales	(600)	(1100)
Gross profit	400	900
Administrative expenses	(80)	(130)
Distribution costs	(110)	(150)
Finance costs	(120)	(167)
Profit before tax	90	453
Income tax	(15)	(50)
Profit for the year	75	403

Required:

Calculate the following ratios for both companies and comment on the ratios:

4. Net Profit/sale ratio
5. Gross profit/sale ratio
- 6(a). Cost of sale/sale ratio
- 6(b). Admin expense/sale ratio
- 6(c). Distribution expense/sale ratio

Answer-1

Sr. No	Ratio	Formula	X Limited	Y Limited
1	Return on capital employed	$\frac{\text{Profit before interest \& tax}}{\text{Avg. capital employed}} \times 100$	$\frac{750 + 510}{\frac{10100 + 8300}{2}} \times 100 = 13.69\%$	$\frac{750 + 510}{(9700 + 7700)/2} \times 100 = 14.5\%$
2	Return on shareholder capital/ Return on equity	$\frac{\text{PAT} - \text{Preference Dividend}}{\text{Avg Ordinary Equity}} \times 100$ (Answer is in %)	$\frac{600}{(6,300 + 7,100)/2} \times 100 = 9\%$	$\frac{600}{(5,200 + 5,700)/2} \times 100 = 11\%$
3	Return on asset	$\frac{\text{Profit before int. and tax}}{\text{Avg. total assets}} \times 100$	$\frac{750 + 510}{(13900 + 12500)/2} \times 100 = 9.55\%$	$\frac{750 + 510}{(14400 + 12500)/2} \times 100 = 9.36\%$
7	Sales / capital employed ratio or Asset turnover ratio	$\frac{\text{Net Sales}}{\text{Average Capital Employed}}$	$\frac{12000}{(10100 + 8300)/2} = 1.3 \text{ times}$	$\frac{12000}{(9700 + 7700)/2} = 1.38 \text{ times}$
9	Debtor turnover days	$\frac{\text{Avg. Trade receivable}}{\text{credit sales}} \times 365$	$\frac{(2400 + 1900)/2}{12000} \times 365 = 65 \text{ days}$	$\frac{(1900 + 1100)/2}{12000} \times 365 = 46 \text{ days}$
10	Inventory turnover days	$\frac{\text{Avg. Inventory}}{\text{COS}} \times 365$	$\frac{(4200 + 1600)/2}{9330} \times 365 = 113 \text{ days}$	$\frac{(1500 + 1200)/2}{9330} \times 365 = 53 \text{ days}$
11	Creditor turnover days	$\frac{\text{Avg. Trade Payable}}{\text{Credit purchase}} \times 365$	$\frac{(3200 + 1800)/2}{11930 (w - 1)} \times 365 = 76 \text{ days}$	$\frac{(1600 + 1600)/2}{9630 (w - 2)} \times 365 = 61 \text{ days}$

CHAPTER-11

INTERPRETATION OF FINANCIAL STATEMENTS

12	Business /Cash Cycle	Inventory days + debtor days – Creditor days	$113+65-76 = 102$ days	$53+46-61 = 38$ days
13	Debtor turnover	$\frac{\text{Net Credit Sales}}{\text{Avg. Trade Debtors}}$	$\frac{12,000}{(2400 + 1900)/2} = 5.6$ times	$\frac{12,000}{(1900 + 1100)/2} = 8$ times
14	Stock turnover	$\frac{\text{Cost of Goods Sold} = \text{times}}{\text{Average Inventory}}$	$\frac{9,330}{(4200 + 1600)/2} = 3.22$ times	$\frac{9,330}{(1500 + 1200)/2} = 6.9$ times
15	Creditor turnover	$\frac{\text{Net Credit Purchases} = \dots \text{times}}{\text{Avg. Trade Creditors}}$	$\frac{11,930(w-1)}{(3,200 + 1800)/2} = 4.7$ times	$\frac{9,630(w-2)}{(1600 + 1600)/2} = 6$ times
16	Current Ratio	$\frac{\text{Current Asset}}{\text{Current Liabilities}}$	$\frac{8,900}{3,800} = 2.34$ times	$\frac{5,600}{4,700} = 1.19$ times
17	Quick Ratio	$\frac{(\text{Current Assets} - \text{Inventory})}{\text{Current Liabilities}}$	$\frac{8,900 - 4,200}{3,800} = 1.2$ Times	$\frac{5,600 - 1,500}{4,700} = 0.87$ Times
18	Gearing ratio Option 1	$\frac{\text{Long term loan}}{(S.C + S.P + R.E)} \times 100$	$\frac{3,000}{7,100} \times 100 = 42\%$	$\frac{4,000}{5,700} \times 100 = 70\%$
	Option 2	$\frac{\text{Long term loan}}{\text{Equity} + \text{Long term loan}} \times 100$	$\frac{3,000}{7,100 + 3,000} \times 100 = 29\%$	$\frac{4,000}{5,700 + 4,000} \times 100 = 41\%$

(W-1)

Inventory a/c (X Limited)

Cr.

Dr.	1,600			9,330
op.				
		COS		
	11,930			
		cl.		
Purchases (bal.)				$\frac{4,200}{13,530}$

(W-2)

Inventory a/c (Y Limited)

Cr.

Dr.	1,200			9,330
op.				
		COS		
	9,630			
		cl.		
Purchases (bal.)				$\frac{1,500}{10,830}$

Answer-2

S. No	Ratio	Formula	A Limited	B Limited
4	Net Profit/sales ratio	$\frac{\text{Profit After Tax}}{\text{Net Sales}} \times 100 = \dots\%$	$\frac{75}{1000} \times 100 = 7.50\%$	$\frac{403}{2000} \times 100 = 20.15\%$
5	Gross Profit/sales ratio	$\frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \dots\%$	$\frac{400}{1000} \times 100 = 40\%$	$\frac{900}{2000} \times 100 = 45\%$
6(a)	Cost of sale/sale ratio	$\frac{\text{Cost of sale}}{\text{Net sales}} \times 100 = \dots\%$	$\frac{600}{1,000} \times 100 = 60\%$	$\frac{1100}{2000} \times 100 = 55\%$
6(b)	Admin Expense/sale ratio	$\frac{\text{Admin Expense}}{\text{Net sales}} \times 100 = \dots\%$	$\frac{80}{1,000} \times 100 = 8\%$	$\frac{130}{2,000} \times 100 = 6.5\%$
6(c)	Distribution Expense/sale ratio	$\frac{\text{Distribution Expense}}{\text{Net sales}} \times 100 = \dots\%$	$\frac{110}{1,000} \times 100 = 11\%$	$\frac{150}{2,000} \times 100 = 7.5\%$

InterpretationProfitability Ratios

S. No.	Ratio	Formula	Utility	Interpretation
1.	"Return on capital employed" (ROCE) Return means profit [Refer Q-1]	$\frac{\text{Profit before interest \& tax}}{\text{Avg Capital Employed}} \times 100$ <p>(Answer is in %)</p> <p>Capital Employed = Equity + Long Term Loans</p> <p>Capital employed = Total Assets less current liabilities</p>	<p>It measures how efficiently a company is generating profits from its capital employed</p> <p>The ratio shows the return on total funds invested in the business.</p> <p>The higher the ratio, the better it is. Capital employed means fund invested in the business.</p>	<ol style="list-style-type: none"> 1. It shows that a profit of Rs. 14.5 is earned by Co. Y on every Rs. 100 invested in business and a profit of Rs. 13.7 is earned by Co. X on every 100 invested in business. 2. Business Y is better than Business X as Co. Y has made far better use of its capital achieving a profit of Rs. 14.5 for every Rs. 100 invested, whereas Co. X has achieved a profit of only Rs. 13.7 per Rs. 100 invested. 3. Business Y can invest greater portion of its capital back into business. 4. A comparison should also be made with: <ul style="list-style-type: none"> • entity's own performance over the years and • industry averages. 5. Further the return should be higher as compared to interest rate on loan borrowed.
2.	Return on ordinary shareholder capital/ Return on equity [Refer Q-1]	$\frac{\text{Profit after tax less irredeemable Preference Dividend}}{\text{Avg Ordinary Equity}} \times 100$ <p>(Answer is in %)</p>	<p>It measures how efficiently a company is generating profits from amount invested by its shareholders.</p> <p>The higher the ratio, the better it is.</p>	<ol style="list-style-type: none"> 1. It shows that profit of Rs. 9 is earned by company X on every Rs. 100 invested by shareholder <u>however</u> company Y earned profit of Rs. 11 on every Rs. 100 invested by shareholder therefore Co. Y is better than Co. X 2. Same as above

			<p>3. Business Y can pay more dividends to its shareholders and has more money to reinvest in business. Business X can pay less dividends to its shareholders and has less money to reinvest in business.</p> <p>4. Same as above.</p>		<p>3. Business Y can pay more dividends to its shareholders and has more money to reinvest in business. Business X can pay less dividends to its shareholders and has less money to reinvest in business.</p> <p>4. Same as above.</p>
3.	Return on assets Total or non-current as you wish [Refer Q-1]	$\frac{\text{Profit before interest \& tax}}{\text{Avg Total assets}} \times 100$ <p>(Answer in %)</p> <p>Sometimes organizations use non-current assets as denominator</p>	<p>It measures how efficiently management turns its assets into profit.</p> <p>The higher the ratio, the better it is.</p>	<p>After investing assets of Rs. 100 in business Co. X is generating Rs. 9.55 profit and Co. Y is generating Rs. 9.36 profit.</p> <p>Therefore Co. X is better.</p> <p>A comparison should also be made with:</p> <ul style="list-style-type: none"> entity's own performance over the years and industry averages. 	<p>4. Same as above.</p> <p>After investing assets of Rs. 100 in business Co. X is generating Rs. 9.55 profit and Co. Y is generating Rs. 9.36 profit.</p> <p>Therefore Co. X is better.</p> <p>A comparison should also be made with:</p> <ul style="list-style-type: none"> entity's own performance over the years and industry averages.
4.	Net Profit/sales ratio [Refer Q-2]	$\frac{\text{Profit After tax}}{\text{Net Sales}} \times 100$ <p>(Answer in %)</p>	<p>It shows net profit that is earned for every 100 rupees of sale. OR It shows percentage of sales that is leftover after business has paid all its expenses.</p> <p>The higher the ratio, the better it is.</p>	<p>Co. A results show Rs. 7.5 are earned for every Rs. 100 of sale and Co. B earned Rs. 20 for every Rs. 100 of sale.</p> <p>Therefore Co. B is better</p>	<p>Co. A results show Rs. 7.5 are earned for every Rs. 100 of sale and Co. B earned Rs. 20 for every Rs. 100 of sale.</p> <p>Therefore Co. B is better</p>
5.	Gross Profit/sales ratio [Refer Q-2]	$\frac{\text{Gross Profit}}{\text{Net Sales}} \times 100$ <p>(Answer in %)</p>	<p>It shows gross profit that is earned for every 100 rupees of sale. It should be sufficient enough to pay all expenses.</p> <p>The higher the ratio, the better it is.</p> <p>Sometimes sales increase but gross profit does not. Reasons:</p> <ol style="list-style-type: none"> Cost of purchases increased How much is sold for each type of goods To increase sale, sale price has been reduced 	<p>Co. A results show Rs. 40 gross profit is earned for every Rs. 100 of sale and Co. B results show Rs. 45 gross profit is earned for every Rs. 100 of sale</p> <p>Therefore Co. B is better.</p> <p>It can also be interpreted that company A may reduce selling price upto 40% without incurring any loss.</p>	<p>Co. A results show Rs. 40 gross profit is earned for every Rs. 100 of sale and Co. B results show Rs. 45 gross profit is earned for every Rs. 100 of sale</p> <p>Therefore Co. B is better.</p> <p>It can also be interpreted that company A may reduce selling price upto 40% without incurring any loss.</p>

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INTERPRETATION OF FINANCIAL STATEMENTS

6.	<p>a) Cost of sales/Sale ratio [Refer Q-2]</p> <p>b) Admin expense/sales ratio [Refer Q-2]</p> <p>c) Selling expense/sales ratio [Refer Q-2]</p>	$\frac{\text{Cost of sales}}{\text{Net Sales}} \times 100$ <p>(Answer in %)</p> $\frac{\text{Admin expense}}{\text{Net Sales}} \times 100$ <p>(Answer in %)</p> $\frac{\text{Selling Expenses}}{\text{Net Sales}} \times 100$ <p>(Answer in %)</p>	<p>It shows what extent of sale is an individual expense.</p> <p>The lower the ratio the better it is.</p> <p>The cost of sale/sale ratio does not change normally with change in sale.</p> <p>However admin/selling expenses normally change with change in sales.</p> <p>These ratios help in controlling and estimating future expenses.</p>	<p><u>COS/sale ratio</u> In Co. A every 60 rupees out of 100 rupees of sale are cost of sale. In Co. B every 55 rupees out of 100 rupees of sale are cost of sale. Therefore, Co. B is better.</p> <p><u>Admin exp./sale ratio</u> In Co. A every 8 rupees out of 100 rupees of sale are spent on admin expenses. In Co. B every 6.5 rupees out of 100 rupees of sale are spent on admin expenses. Therefore, Co. B is better.</p> <p><u>Selling exp./sale ratio</u> In Co. A every 11 rupees out of 100 rupees of sale are spent on admin expenses. In Co. B every 7.5 rupees out of 100 rupees of sale are spent on admin expenses. Therefore, Co. B is better.</p>
7.	<p>Sales / capital employed ratio or Asset turnover ratio [Refer Q-1]</p>	$\frac{\text{Net Sales}}{\text{Average Capital Employed}}$ <p>(Answer is in times)</p>	<p>It measures how efficiently a company is making sales from assets.</p> <p>The higher the ratio the better it is.</p>	<p>The figure shows that 1 rupee of capital employed is generating a sale of Rs.1.3 for Co. X and 1.38 for Co. Y. Therefore Co. Y is better than Co. X</p> <p>The age of company assets play an important role in it. A company having assets with low book value might have higher ratio as compared with a company having newer assets with high book value. So caution must be exercised while interpreting this ratio.</p>

8.	Percentage annual growth in sales	It can be useful to measure the annual growth (or decline) in sales, measured as a percentage of sales in the previous year. For example, if sales in the year just ended were Rs.5,800,000 and sales in the previous year were Rs.5,500,000, the annual growth in sales has been $(Rs.300,000/Rs.5,500,000) \times 100\% = 5.45\%$.
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Working Capital Efficiency Ratios

Purpose of working capital efficiency ratios

The working capital ratios are a useful measure of whether the entity has too much or too little invested in working capital.

Excessive investment in working capital is indicated by a long cash cycle that appears to be getting even longer. When too much is invested in working capital, the return on capital employed will be lower.

Under-investment in working capital is an indication of possible liquidity difficulties.

(The cash cycle, also called the operating cycle and the working capital cycle, is explained later).

S. No.	Ratio	Formula	Utility	Interpretation
9.	Debtor Turnover Days (Average time to collect debtors / Receivable days / Debtor collection period / Days sales outstanding) [Refer Q-1]	$\frac{\text{Average Debtor}}{\text{Credit Sales}} \times 365$ (Answer in days)	Measures the average number of days taken by an entity to collect its receivables. A long average time suggests inefficient collection from debtor. The lower the days the better it is.	Company X results show that debtors are collected in 65 days of sale and Co. Y sales shows that debtors are collected in 46 days. Therefore Co. Y is better. The results should also be compared with industry average and credit period agreed.
10.	Inventory Turnover Days (Average Time for holding inventory / Inventory days) [Refer Q-1]	$\frac{\text{Average Inventory}}{\text{Cost of Goods Sold}} \times 365$ (Answer in days)	It measures the number days required to sell the inventory during the year. A small number of days indicate that a company is more efficient at selling its inventory. The lower the days, the better it is. A lengthy inventory period may indicate excessive buildup of inventories.	Company Y results show that Inventory is sold within 53 days that is more quickly than Company X. Therefore Company Y is efficient as it is selling inventory quickly as compared to company X.

11.	Creditor Turnover Days (Time to pay suppliers/ Creditor days) [Refer Q-1]	$\frac{\text{Avg Creditor}}{\text{Credit Purchase}} \times 365$ (Answer in days)	It measures the average number of days in which a company makes payment to its suppliers. It is compared with agreed credit period. If its too high then there is a risk of the suppliers not extending credit in future and may loose goodwill.	Company Y is paying to its creditors in 61 days and company X is paying in 76 days. Anyways these should also be compared with agreed credit period to get better decision.
12.	Cash operating cycle/ working capital cycle [Refer Q-1]	Inventory days + debtor days – Creditor days	It is the length of time between organization's payment for purchases and receipt of cash from debtors. It should not be unreasonable in length. Longer cycle means too much is invested in inventories and debtors. The shorter the cycle the better it is. The reasons of being shorter could be: 1. Inventories sold rapidly 2. Collecting debts quickly 3. Taking maximum credit possible	Company Y has short cash cycle as compared to company X which tells us that company Y is in better management of its working capital.
13.	Debtor/Receivable turnover [Refer Q-1]	$\frac{\text{Net Credit Sales}}{\text{Avg Trade Debtors}}$ (Answer is in times)	It shows speed within which debtors are collected. The higher the turnover, the shorter the time between sales and collecting cash. Higher turnover ratio shows speedy and effective collection.	Debtors for company Y get converted into cash 8 times a year and Debtors for company X get converted into cash 5.6 times a year. Therefore company Y is better.
14.	Stock turnover [Refer Q-1]	$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$ (Answer is in times)	It shows how many times stock is converted into sales. A high ratio indicates inventory is selling quickly. If the ratio is low, it suggests overstocking, obsolete inventory or selling issues. The higher the turnover the better it is.	Company Y stock is converted 6.9 times in sale and Company X stock is only converted 3.2 times in sale. Therefore company Y is efficient in selling stock. It should be compared over time and with industry averages.

S. No.	Ratio	Formula	Utility	Interpretation
15.	Creditor/ Payable turnover [Refer Q-1]	$\frac{\text{Net Credit Purchases}}{\text{Avg Trade creditors}}$ (Answer is in times)	It shows speed within which we are making payment to creditors. The higher the turnover, the shorter the period between purchases and payment. Higher turnover on one side shows that our creditors are happy however on other side we are not using supplier funds to finance our operations. A low turnover may be a sign of cash flow problems.	Company Y is making speedily payment to its creditors as compared to company X. However any conclusion can be drawn only if the credit period agreed is given.

Liquidity ratios

S. No.	Ratio	Formula	Utility	Interpretation
16.	Current Ratio [Refer Q-1]	$\frac{\text{Current Asset}}{\text{Current Liabilities}}$ (Answer is in times)	The ratio indicates the ability of the company to pay its current obligation out of the current assets. An ideal current ratio is 2:1. A very high current ratio may mean there is excess cash that should possibly be invested elsewhere in the business or that there is too much inventory.	A ratio of 2.3 for co. X shows that to pay Rs. 1 of current liability we have Rs. 2.3 of current assets available. This means after paying liabilities we still have Rs 1.3 and for Co. Y shows that to pay Rs. 1 of current liability we have Rs. 1.19 of current assets available. This means after paying liabilities we still have Rs 0.19, therefore, Co. X is in a better position to pay its current liabilities. A deeper analysis would reveal a good result because current assets may include obsolete or slow moving inventory. A better decision can be made if we see: <ul style="list-style-type: none"> • Change over time • Ratios of other companies • Industry average ratios

S. No.	Ratio	Formula	Utility	Interpretation
17.	Quick ratio/ Acid test ratio [Refer Q-1]	$\frac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}}$ (Answer is in times)	<p>The ratio indicates the ability of the company to pay its current obligation out of the quick assets.</p> <p>It is a better measurement of liquidity than current ratio.</p> <p>An ideal quick ratio is 1:1.</p>	<p>A ratio of 1.2 for co. X shows that to pay Rs. 1 of current liability we have Rs. 1.2 of quick assets available. This means after paying liabilities we still have Rs. 0.2 In Co. Y to pay Rs. 1 of current liability we have Rs. 0.87 of quick assets available. This means that Co. Y is not in a position to pay its current liabilities from quick assets.</p> <p>Therefore, Co. X is better.</p> <p>A better decision can be made if see:</p> <ul style="list-style-type: none"> • Change over time • Ratios of other companies • Industry average ratios

Debt Ratio

S. No.	Ratio	Formula	Utility	Interpretation
18.	Gearing (It is also called as leverage) [Refer Q-1]	<p>a) $\frac{\text{Long term loans}}{\text{Equity}} \times 100$ (Answer in %)</p> <p>OR</p> <p>b) $\frac{\text{Long term loans}}{\text{Equity} + \text{long term loans}} \times 100$ (Answer in %)</p>	<p>This ratio compares company's total debts to company's equity</p> <p><u>High geared or high leveraged company</u></p> <p>It is the case when debt capital exceeds the equity</p> <p>If answer to a) is above 100% or answer to b) is above 50% the company is said to be highly geared. It means debt is greater than equity and the company is risky as it relying more on debt.</p>	<p>The ratio of both the companies under option 1 is below 100%. It means both of the companies are low geared. However Co. Y is more risky than Co. X because it has gearing ratio. Company Y results show that it relies heavily on external lenders.</p>

		Note: Irredeemable preference shares are considered as equity and redeemable preference shares are considered just like long term loan.	Low geared or low leveraged company Opposite of above discussion Dangers of high gearing 1. Difficult to obtain more loan 2. Entity may not be able to meet its obligations.	
18.	Interest Cover Ratio	$\frac{\text{Profit before interest \& tax}}{\text{Interest expense}}$		

Some more practice of liquidity ratios

1) Working Capital

Company A has Current Assets of Rs. 500,000 and Current Liabilities of Rs. 400,000.

Company B has Current Assets of Rs. 500,000 and Current Liabilities of Rs. 600,000.

Solution

Ratio	Formula	Company A	Company B
Working capital	Current Asset - Current Liabilities	$500,000 - 400,000 =$ Rs. 100,000	$500,000 - 600,000 =$ Rs. (100,000)

Interpretation

Company A has surplus funds to meet current liabilities.

Company B has deficit funds to meet current liabilities.

2) Current Ratio

Company A has Current Assets of Rs. 400,000 and Current Liabilities of Rs. 200,000.

Company B has Current Assets of Rs. 400,000 and Current Liabilities of Rs. 800,000.

CHAPTER-11

INTERPRETATION OF FINANCIAL STATEMENTS

Solution

Ratio	Formula	Company A	Company
Current Ratio	$\frac{\text{Current Asset}}{\text{Current Liabilities}}$	$\frac{400,000}{200,000} = 2 \text{ Times}$ (CA are 2 Times of CL)	$\frac{400,000}{800,000} = 0.5 \text{ Times}$ (CA are 0.5 Times of CL)

Interpretation

If answer is less than 1 then it means that we are not in a position to settle our CL from CA in next 1 year.

The liquidity position of Company A is better because for every 1 rupees of CL we have 2 rupees of CA whereas the liquidity position of Company B is not better because for every 1 rupees of CL we have 0.5 rupees of CA.

3) Acid Test or Liquid or Quick Ratio

Company A has Current Assets of Rs. 600,000 including inventories of Rs. 300,000 and Current Liabilities of Rs. 300,000.

Company B has Current Assets of Rs. 600,000, including inventories of Rs. 160,000 and Current Liabilities of Rs. 900,000.

Solution

Ratio	Formula	Company A	Company
Quick Ratio	$\frac{(\text{Current Assets} - \text{Inventory})}{\text{Current Liabilities}}$	$\frac{600,000 - 300,000}{300,000} = 1 \text{ Times}$ (Liquid Assets are 1 times of CL)	$\frac{600,000 - 160,000}{900,000} = 0.49 \text{ Times}$ (Liquid Assets are 0.49 times of CL)

Interpretation

If answer is less than 1 then it means that we are not in a position to settle our current liabilities from liquid assets in current year.

The liquidity position of Company A is better because for every 1 rupee of CL we have 1 rupee of Liquid Assets whereas the liquidity position of Company B is not better because for every 1 rupee of CL we have 0.49 rupees of Liquid Assets.

Working Capital Ratios**4) Inventory Turnover Ratio**

Company A has sold goods costing Rs. 850,000 and average inventory having cost of Rs. 75,000. Company B has sold goods costing Rs. 8,500,000 and average inventory having cost of Rs. 75,000.

Solution

Ratio	Formula	Company A	Company
Inventory Turnover Ratio	$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}} = \dots \text{ Times}$	$\frac{850,000}{75,000} = 11.33 \text{ Times}$	$\frac{8,500,000}{75,000} = 113.33 \text{ Times}$

Interpretation

Company B has better performance than Company A because activity level of company B is 113 times whereas company A has only 11 times.

5) Inventory Turnover Period

Company A has sold goods costing Rs. 850,000 and average inventory having cost of Rs. 75,000.

Company B has sold goods costing Rs. 8,500,000 and average inventory having cost of Rs. 75,000.

There are 365 days in a year.

Solution

Ratio	Formula	Company A	Company
Inventory Turnover period	$\frac{\text{Average Inventory}}{\text{Cost of sales}} \times 365$	$\frac{75,000}{850,000} = 32 \text{ days}$ (we sell the stock within 32 days after purchasing)	$\frac{75,000}{8,500,000} \times 365 = 3 \text{ days}$ (we sell the stock within 3 days after purchasing)

Interpretation

Company B has better sales volume as it sells its inventory within 3 days after purchasing whereas Company A sells its inventory within 32 days which is very long. The minimum the days, the better it is.

INTERPRETATION OF FINANCIAL STATEMENTS

6) Debtor Turnover Ratio

Company A has net credit sales of Rs. 1,300,000 and average trade debtors of Rs. 80,000. Company B has net credit sales of Rs. 1,300,000 and average trade debtors of Rs. 80,000.

Solution

Ratio	Formula	Company A	Company
Debtor Turnover Ratio	$\frac{\text{Net Credit Sales}}{\text{Avg. Trade Debtors}}$	$\frac{1,300,000}{80,000} = 1.6 \text{ times}$	$\frac{1,300,000}{80,000} = 16.3 \text{ times}$

Interpretation

Company B has better performance because company B has speedy and effective collection policies which are 16.3 times whereas Company A has only 1.6 times. The higher the ratio the better it is.

7) Debtor Turnover Period

Company A has net credit sales of Rs. 1,300,000 and average trade debtors of Rs. 80,000.

Company B has net credit sales of Rs. 1,300,000 and average trade debtors of Rs. 80,000.

A year has 365 days.

Solution

Ratio	Formula	Company A	Company
Debtor Turnover Period	$\frac{\text{Average Debtors}}{\text{Net credit sales}} \times 365$	$= \frac{80,000}{1,300,000} \times 365 = 22.5 \text{ days}$	$= \frac{80,000}{1,300,000} \times 365 = 22 \text{ days}$

Interpretation

The lower the days the better it is. The number of days Company B needs to recover from its debtors is 22 days which are far less than the number of days Company A needs which are 22.5 days. So company B is performing better than company A.

8) Creditor Turnover Ratio

Company A has purchased goods on credit of Rs. 150,000 and average creditors are Rs. 40,000. Company B has purchased goods on credit of Rs. 170,000 and average creditors are Rs. 30,000.

Solution

Ratio	Formula	Company A	Company B
Creditor turnover Ratio	$\frac{\text{Net Credit Purchases}}{\text{Avg. Trade Creditors}} = \text{Times}$	$\frac{150,000}{40,000} = 3.75 \text{ times}$	$\frac{170,000}{30,000} = 5.67 \text{ times}$

9) Creditor Turnover Period

Company A has purchased goods on credit of Rs. 150,000 and average creditors are Rs. 40,000.

Company B has purchased goods on credit of Rs. 170,000 and average creditors are Rs. 30,000.

A year has 365 days.

Solution

Ratio	Formula	Company A	Company
Creditor Turnover Period	$\frac{\text{Avg. Trade Creditors}}{\text{Net Credit purchase}} \times 365$	$\frac{40,000}{150,000} \times 365 = 97 \text{ days}$	$= \frac{30,000}{170,000} \times 365 = 64 \text{ days}$

LO 2: FINANCIAL STATEMENTS ANALYSIS

Financial statement analysis is the process of analysing a company's past, current and projected performance for decision-making purposes

Financial statement analysis allows analysts to identify trends by comparing ratios across multiple periods and statement types to allow analysts to measure liquidity, profitability, company-wide efficiency, and cash flow.

Financial statement analysis is of the following types:

- Horizontal analysis
- Vertical analysis
- Ratio analysis (already explained in above sections)

1. Horizontal analysis

Horizontal analysis is used to compare historical data, such as ratios, or line items, over a number of accounting periods.

Financial analysts and investors need to identify trends and growth patterns in the company's performance over a number of years, a year-end balance sheet or income statement is not enough to evaluate whether the company is operating efficiently and profitably.

Horizontal analysis also makes it easier to compare growth rates and profitability among different companies.

The following is the formula for horizontal analysis:

$$\frac{\text{Amount in comparison year} - \text{Amount in base year}}{\text{Base year}} \times 100$$

The following figure is an example of how to prepare a horizontal analysis for two years.

Carnations Ltd
Profit & Loss Account
For the year ended December 31, 2018

	2018	2017	%age change from 2017 to 2018
	Rs. in millions		
Sales	86,320	75,200	14.79
Cost of Sales	(44,618)	(40,900)	9.09
Gross Profit	41,702	34,300	21.58
Distribution costs	(19,597)	(15,380)	27.42
Administrative expenses	(2,339)	(2,053)	13.93

	2018	2017	% age change from 2017 to 2018
	Rs. in millions		
Other operating expenses	(1,322)	(1,052)	25.67
Other income	1,488	1,000	48.80
Profit before interest	19,932	16,815	18.54
Finance cost	(343)	(300)	14.33
Profit before taxation	19,589	16,515	18.61

2. Vertical analysis

In vertical analysis each category of accounts on the balance sheet is shown as a percentage of the total account.

Line items on an income statement can be stated as a percentage of gross sales, while line items on a balance sheet can be stated as a percentage of total assets or liabilities. This analysis of income statements gives the company a heads up if cost of goods sold or any other expense appears to be too high when compared to sales and allows the management to identify the reasons and take action to fix the problem(s).

Carnations Ltd
Statement of Financial Position
For the year ended December 31, 2018

	2018	2017
	----- Rs. in millions -----	
Assets		
Non-Current Assets		
Property, plant & equipment	15,000	12,000
Intangibles	500	600
Long term investments	120	100
Long term loans	200	150
Long term deposits and prepayments	70	180
	15,890	13,030
Current Assets		
Stores and spares	650	585
Stock in trade	6,000	5,500
Trade debts	2500	1200
Loans and advances	800	300
Short term deposits and prepayments	750	900
Other receivables	350	175
Cash and bank balances	8,500	15,000
	19,550	23,660
Total assets	35,440	36,690

	2018	2017
	----- Rs. in millions -----	
Equity and liabilities		
Share capital and reserves		
Share capital	1,000	1,000
Reserves	2,950	7,095

Liabilities				
Non-current liabilities				
Staff retirement benefits	290	0.82%	295	0.80%
Current liabilities				
Trade and other payables	30,000	84.65%	27,500	74.95%
Provisions	1200	3.39%	800	2.18%
Total current liabilities	31,200	88.04%	28,300	77.13%
Total liabilities	31,490	88.85%	28,595	77.94%
Total equity and liabilities	35,440		36,690	

Carnations Ltd**Profit & Loss Account**

For the year ended December 31, 2018

	2018	2017
	Rs. in millions	
Sales	86,320	75,200
Cost of Sales	(44,618)	(40,900)
Gross Profit	41,702	34,300
Distribution costs	(19,597)	(15,380)
Administrative expenses	(2,339)	(2,053)
Other operating expenses	(1,322)	(1,052)
Other income	1,488	1,000
Profit before interest	19,932	16,815
Finance cost	(343)	(300)
Profit before taxation	19,589	16,515
	22.69%	21.96%

LO 3: LIMITATIONS OF RATIO ANALYSIS:

1. Inflation may distort comparison of ratios over time.
2. Different accounting policies may distort inter-company comparison.
3. The ratios are only as good as the financial information on which they are based.
4. The accounting information used to prepare the ratios may be out of date.
5. Changes in accounting policies from year to year may produce misleading ratios.
6. Financial statements on which ratios are based only reflect the financial information but not the complete picture of business conditions.

Window dressing

One should also be careful of unethical practices like window dressing while interpreting the financial statements. Window dressing is the adaptation of the rules and practices to present financial statements in a way that business situation appears better than it actually is. This manipulates the financial information and misleads the users of financial statements.

Examples

Some of the ways in financial statements may be manipulated include:

- Delay in paying suppliers, so that the period-end cash balance appears higher.
- Using lower estimate for allowance for doubtful debts.
- Capitalize smaller expenditures that would normally be charged to expense, to increase reported profits.
- Offer customers an early shipment discount, thereby accelerating revenues from a future period into the current period.
- Lower depreciation expense by using higher useful lives or residual values, etc.

PRACTICE SET QUESTIONS**Question- 1: Business Cycle**

Goods purchase and payment made on cash
 Goods sold on credit on
 Cash received from customers on

Required:

Calculate business cycle.

1-3-2016
 31-3-2016
 18-4-2016

Question- 2

Goods purchased on
 Payment for goods is made on
 Goods are sold on credit on
 Cash is received from customers on

Required:

Calculate business cycle.

1-1-2008
 15-1-2008
 31-1-2008
 8-2-2008

Question- 3

The following information pertains to Shale Distributors Limited (SDL):

	Rs. in million
Sales	300
Purchases	140
Cost of goods sold	150
Trade receivables	50
Trade payables	21
Inventories	30

All the purchases and sales are on credit.

Required:

Calculate the cash operating cycle of SDL and explain briefly its significance.
 (Assume a 360-day year)

Question- 4

You are given the following information about Company R:
 As on 31 December 31-12-2015

	Rs.000
Total assets	7,400
Share capital	1,700
Reserves	2,900
Long-term liabilities (Bank loans)	4,600
Current liabilities	2,000
	800
	7,400

Following are the extracts from profit and loss for year ended December 31, 2015:

Profit before interest and taxation	Rs. 000
Interest	800
Profit before tax	(270)
Taxation	530
Profit after taxation	(130)
	400

Required:

Calculate the gearing ratio at 31 December 2015.

Question- 5

Indicate the effect of the following transactions on working capital by placing a check mark if there is

No effect with justification

Increase with justification

Decrease with justification

1. Purchase of raw material of Rs. 50,000
2. Sale of finished goods of Rs. 65,400
3. Depreciation for the year Rs. 70,000
4. Operating expenses paid of Rs. 90,000
5. Purchased equipment of Rs. 120,000 on account
6. Paid cash Rs. 150,000 on account of payable
7. Received Rs. 20,000 on account of receivables
8. Declared & paid a cash dividend of Rs. 40,000
9. Issued Rs. 100,000 capital for cash.
10. Borrowed Rs. 200,000 on short term loan.

Question- 6

Acoms is a small business with limited liability. Its summarized financial results are given below:

Acoms Statement of comprehensive Income for the year ended 31 May 2007

Revenue	Rs.000
Cost of sales	375
Gross profit	(280)
Distribution & administrative expenses	95
Profit from operations	(45)
Finance costs	50
Profit before tax	(5)
Income tax expense	45
Profit after Tax	(15)
	30

Acoms
Statement of financial position
as at 31 May 2007

	Rs.000	Rs.000
Assets		
Non-current assets		410
Current assets		
Inventory	96	
Trade receivables	34	
Cash and bank	3	133
Total assets		543
Equity and liabilities		
Capital and reserves		
Rs.1 Ordinary shares		300
Retained earnings		90
		390
Current liabilities		
Trade payables	88	
Taxation	15	103
Non-current liabilities		
10% Loan notes		50
Total equity and liabilities		543

Additional Information:

The following are ratios for Acoms for the year to 31 May 2006 and the industry average ratios for 2007:

Ratio	Acoms	Industry Average
	2006	2007
Gross profit percentage (%)	34.7	30.0
Operating profit percentage (%)	17.7	20.0
Current ratio	1.5	1.5
Acid test (Quick) ratio	1.1	1.0
Receivables collection period (days)	16.0	20.0

Required:

- a) Calculate the following ratios for Acoms for the year, ended 31 May 2007. State clearly the formula used for each ratio.
 - (i) Gross profit percentage.
 - (ii) Operating profit percentage
 - (iii) Current ratio
 - (iv) Acid test (Quick) ratio
 - (v) Receivables Collection period
- b) Use the information given and the ratios you calculated in part (a) to comment on the performance of Acoms.

Question-7

Given below is the information of a listed company

Balance Sheet

Assets	Rs.
Fixed Assets at W.D.V.	1,150,000
Investments	300,000
Current Assets	
Stock	310,000
Sundry Debtors	350,000
Advances	100,000
Cash and Bank Balance	40,000
	800,000
Total Assets	2,250,000
Capital and Liabilities	
Share Capital	700,000
Unappropriated Profit (Retained Earnings)	250,000
	950,000
Long Term Loans	725,000
Current Liabilities	
Accounts Payable	125,000
Sundry Creditors	250,000
Accrued and other liabilities	200,000
	575,000
	2,250,000
Profit and Loss Account	
Sales	1,675,000
Cost of Sales	(1,000,000)
Gross Profit	675,000
Administrative Expenses	(250,000)
Selling Expenses	(225,000)
Profit before tax	200,000
Taxation	(50,000)
Profit after tax	150,000

Required:

a) Calculate:

- (i) Acid Test Ratio
- (ii) Debtors Turnover Ratio
- (iii) Inventory Turnover Ratio
- (iv) Assets Turnover Ratio

b) Convert the income statement figures into percentages on the basis of sales.

Question-8**Income statements for the years ended 31 December 2013**

Revenue
Cost of sales
Gross profit
Admin expenses
Selling expense
Profit before tax and int.(Operating profit)
Finance costs
Profit before tax
Taxation
Profit for the year

Waseem Rs. '000'	Junaid Rs. '000'
16,000	11,500
(8,800)	(2,425)
7,200	9,075
(600)	(800)
(400)	(200)
6,200	8,075
(800)	(600)
5,400	7,475
(700)	(600)
4,700	6,875

Statements of financial position at 31 December 2013

Assets
Non-current assets
Property, Plant and equipment
Current assets
Total assets
Equity and liabilities
Equity
Equity' shares of Rs. 1 each
Share premium
Retained earnings
Irredeemable preference share
Non-current liabilities
40% Redeemable preference share
Current liabilities
Total equity and liabilities

Waseem Rs. '000'	Junaid Rs. '000'
10,000	8,000
6,000	8,500
16,000	16,500

6,000	7,000
1,000	900
4,000	3,000
2,000	2,900
13,000	13,800

2,000	1,500
1,000	1,200
16,000	16,500

Irredeemable preference dividend is declared by Waseem and Junaid company Rs.500,000 and Rs.800,000 respectively.

Calculate the following ratios:

1. Return on capital employed
2. Return on assets
3. Return on ordinary equity

Question- 9

Following are the data related to Yee Co.

Gross profit
Closing stock decreased compared to opening Stock
Gross profit rate
Stock turnover
Debtors Turnover
Creditors Turnover

Rs.
35,000,000
75,000
33%
3 times
3 times
5 times

Required:

Calculate the following:

- Sales
- Cost of sales
- Trade debtors
- Trade creditors
- Stock in hand

Question- 10

Sulal Limited (SL) is planning to acquire 100% shareholdings in Waris Limited (WL). Before submission of financial proposal, SL is carrying out an analysis of WL's financial and operating performance. The CFO of SL has gathered the following information which is based on the financial statements for the year ended December 31, 2008:

Description	WL's Ratios	Industry Ratios		
		High	Low	Average
Operating Performance Ratios				
Gross profit	29%	30%	20%	25%
Operating profit	11%	15%	10%	13%
Return on shareholders equity	9%	13%	7%	10%
Working Capital Ratios				
Current ratio	1.54 : 1	2 : 1	1 : 1	1.5 : 1
Inventory turnover days	83 days	114 days	81 days	91 days
Receivables collection	93 days	95 days	60 days	74 days
Gearing Ratios				
Debt equity ratio	55 : 45	60 : 40	40 : 60	50 : 50
Interest cover	1.3 times	3 times	1.2 times	2 times

Required:

Draft a report to the board of directors, on behalf of the CFO, analyzing the financial performance of Waris Limited by evaluating each category of ratios in comparison with the industry. (Do not write your name or any identification in the report)

Question- 11

Regan Products Plc. is a company which has had some problems with its overseas supply chain and would like to acquire a suitable company based in the UK that manufactures certain items from its product range. It has identified two possible private limited companies, Edgar Ltd and Oswald Manufacturing Ltd, and obtained the following draft financial statements for each. The management of each company has indicated that they would be receptive to a takeover.

Income statements for the year ended 31 March 2013

	Edgar Rs. '000'	Oswald Rs. '000'
Revenue	12,000	20,500
Cost of sales	(9,330)	(15,440)
Gross profit	2,670	5,060
Administrative expenses	(920)	(2,040)
Distribution costs	(490)	(1,020)
Finance costs	(210)	(300)
Loan notes	-	(10)
Overdraft	-	(290)
Bank loan	1,050	1,400
Profit before tax	(150)	(400)
Income tax	900	1000
Profit after tax		

Statements of financial position at 31 March 2013

	Edgar Rs. '000'	Oswald Rs. '000'
Assets		
Non-current assets		
Freehold factory	4,400	-
Plant and machinery	4,200	6,200
Fixtures and fittings	800	1,300
	9,400	7,500
Current assets		
Inventories	2,000	3,600
Trade receivables	2,400	3,700
Bank and cash	600	-
	5,000	7,300
Total assets	14,400	14,800
Equity and liabilities		
Equity		
Equity shares of Rs. 1 each	2,000	2,000
Share premium	900	-
Revaluation reserve	1,200	-
Retained earnings	3,000	800
	7,100	2,800

Non-current liabilities

Bank loan
7% loan notes
10% loan notes

-	3,700
3,000	-
-	3,000
3,000	6,700

Current liabilities

Bank overdraft
Trade payables
Taxation

-	1,200
3,700	3,900
600	200
4,300	5,300
14,400	14,800

Total equity and liabilities

Notes:
1. Both companies operate from similar premises. Edgar Ltd owns the freehold of its factory, and Oswald Manufacturing Ltd, rents its premises. Edgar Ltd adopts the revaluation method for its premises.

The original cost of the plant and machinery in each company was:

Edgar Ltd	
Oswald Manufacturing Ltd	Rs.5,800,000
	Rs.18,700,000

There were no significant disposals of non-current assets during the year by either company.
2. The companies paid the following dividends during the year:

Edgar Ltd	
Oswald Manufacturing Ltd	Rs. 250,000
	Rs. 700,000

Required:

Calculate following ratios for both companies:

- Working capital
- Current ratio
- Liquid ratio (Quick Assets ratio)
- Inventory turnover
- Inventory holding period
- Debtor turnover
- Trade receivables' collection period
- Creditor turnover
- Trade payables' payment period
- Business/Cash cycle
- Asset turnover
- Gross profit percentage
- Operating profit margin
- Expense ratio
- Net Profit after Tax
- Net Profit before Tax
- Return on assets/investments
- Return on capital employed
- Return on equity
- Debt equity ratio

Note: You should use closing balances rather than averages for computing the ratios.

Question-12

Highway & Co is a railway company. Highway & Co operates a passenger railway service and is responsible for the operation of services and the maintenance of track signaling equipment and other facilities such as stations. In recent years it has been criticized for providing a poor service to the travelling public in terms of punctuality, safety and the standard of facilities offered to passengers. In the last year Highway Co has invested over \$20 million in new carriages, station facilities and track maintenance programmes in an attempt to counter these criticisms. Summarized financial results for Highway Co for the last two years are given below.

SUMMARISED INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER

	20X3 Rs. in (m)	20X4 Rs. in (m)
Sales revenue	180.0	185.0
Earnings before interest and tax	18.0	16.5
Interest	(3.2)	(4.7)
Tax	(4.4)	(3.5)
Earnings available to ordinary shareholders	10.4	8.3

SUMMARISED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER

	20X3 Rs. in (m)	20X4 Rs. in (m)
Non-current assets (net)	100.4	120.5
Current assets		
Inventory	5.3	5.9
Receivables	2.1	2.4
Cash	6.2	3.6
	13.6	11.9
Ordinary share capital (\$1 shares)	114	132.4
Reserves	25.0	25.0
Amounts payable after more than one year	45.6	48.2
8% Debenture 20X9	15.0	15.0
Bank loan	20.0	35.0
Payables due within one year	8.4	9.2
	114.0	132.4

Required

- (a) Calculate the following ratios for Highway Co for 20X3 and 20X4, clearly showing your workings.
- Return on capital employed (also known as return on investment) based upon closing capital employed
 - Operating profit ratio
 - Asset turnover
 - Current ratio
- (b) Briefly comment on the financial performance of Highway Co in 20X3 and 20X4 as revealed by the above ratios and suggest causes for any changes.

Question-13

J. Plc. supplies and fits car tyres, exhaust pipes and other components. The company has branches throughout the country. Roughly 60 per cent of sales are for cash (retail sales). The remainder are credit sales made to car hire companies and large organisations with fleets of company cars (business sales). Business sales tend to be more profitable than retail and the company is keen to expand in this area. There is, however, considerable competition. Branch managers are responsible for obtaining business customers and have some discretion over terms of trade and discounts.

The company's computerized accounting system has recently produced the following report for the manager of the Eastown branch for the six months ended 30th September, 20X4:

	Eastown Branch	Average for all branches
Return on capital employed	22%	16%
Gross profit	38%	45%
Selling and promotion costs/sales	9%	6%
Wages/sales	19%	14%
Debtors turnover period (based on credit sales only)	63 days	52 days
Stock turnover period	37 days	49 days

The Eastown branch manager has only recently been appointed and is unsure whether his branch appears well managed. He has asked for your advice.

You are required to compare the performance of the Eastown branch with the average for all branches. Suggest reasons for the differences you identify.

PRACTICE SET SOLUTIONS**Answer- 1**

Inventory turnover period
Debtor turnover period
Creditor turnover period
Business cycle

31 days
18 days

49 days

Answer- 2

Inventory turnover period
Debtor turnover period
Creditor turnover period
Business cycle

31 days
8 days

(15) days
24 days

Answer- 3

Cash operating Cycle = Inventory turnover ratio period + Trade receivable turnover period - Trade payable turnover period
= 72(W-1) + 60(W-2) - 54(W-3)
= 78 days

Workings Notes
(W-1)

Inventory turnover period = $\frac{\text{Inventories}}{\text{Cost of Goods Sold}} \times 360$
= $\frac{30}{150} \times 360$
= 72 days

(W-2)

Trade receivables turnover period = $\frac{\text{Trade receivables}}{\text{Credit Sales}} \times 360$
= $\frac{50}{300} \times 360$
= 60 Days

(W-3)

Trade payable turnover period = $\frac{\text{Trade Payable}}{\text{Credit Purchases}} \times 360$
= $\frac{21}{140} \times 360$
= 54 days

Significance

It shows the time between payment of materials & recovery from debtors. The organization requires financing for this period.

Answer- 4

a)

$$i) \text{ Gearing} = \frac{2,000}{4,600} \times 100 = 43.48\%$$

Or:

$$ii) \text{ Gearing} = \frac{2,000}{(4,600 + 2,000)} \times 100 = 30.30\%$$

(The company is low-gearred.)

Answer- 5**Effect on Working Capital**

1. **No effect:**
Purchase of raw material would either decrease cash or increase liability. On the other hand, it will increase the stock in trade, so there will be no effect on working capital.
2. **Increase:**
Sale of finished goods would either increase cash or increase debtors with sale price, whereas stock in trade will decrease with the cost price, so working capital will increase only with the amount of profit in such sale.
3. **No effect:**
As one effect would be in the income statement and the other would be in fixed assets.
4. **Decrease:**
By making payment of operating expenses, cash would decrease and on the other hand expenses in income statement would increase. Hence, a decrease in working capital. If expenses already accrued have been paid, then no effect.
5. **Decrease:**
A long-term asset would be debited whereas a current liability would be created for it. So decrease in working capital.
6. **No effect:**
After the payment of a current liability out of a current asset (cash) the amount of working capital will remain the same.
7. **No effect:**
As it is conversion of a current asset (debtor) into another current asset (Cash).
8. **Decrease:**
If dividend is paid and declared during the same period, the amount of cash would decrease whereas current liabilities would remain unchanged. Hence a decrease in the amount of working capital.
9. **Increase:**
Cash (a current asset) will increase by the issue of shares. Hence, increase in the amount of working capital.
10. **No change:**
A current asset (cash) would increase as well as current liability (short term loan) would also increase. Hence, no in working capital.

Answer- 6**Acoms**

(i) Gross profit percentage	$\frac{\text{Gross profit}}{\text{Revenue}} \times 100$	$\frac{95}{375} \times 100 = 25.3\%$
(ii) Operating profit percentage	$\frac{\text{Net profit from operations}}{\text{Revenue}} \times 100$	$\frac{50}{375} \times 100 = 13.3\%$
(iii) Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	$\frac{133}{103} = 1.3:1$
(iv) Acid test (Quick) ratio	$\frac{\text{Current assets} - \text{inventory}}{\text{Current liabilities}}$	$\frac{133-96}{103} = 0.36:1$
(v) Receivables collection period	$\frac{\text{Trade receivables}}{\text{Sales}} \times 365$	$\frac{34}{375} \times 365 = 33\text{days}$

(b) **Comments on the performance of Acoms****Gross-Profit**

Gross profit percentage has reduced from the previous year by 27%. This might indicate increased competition in the market and that selling prices have been discounted. Alternatively the cost of purchases may have increased significantly. The situation is particularly worrying because this ratio is now below the industry average by 15.7%.

Operating Profit

The net profit percentage has also deteriorated as compared to previous year and is below the industry average. This suggests that the control of costs needs to be improved if the company is to remain competitive.

Current Ratio

The current ratio has deteriorated slightly on the previous year and also below industry average. The business has sufficient current assets to cover its current liabilities. However, the composition of the current assets is heavily weighted with inventory. The company may have problems converting inventory to cash if it is required quickly (as inventories not converting into cash quickly).

Acid Test Ratio

The acid test ratio gives a better indication of liquidity than the current ratio. This ratio is 0.36:1 and has fallen significantly below the industry average. This ratio suggests the company may be experiencing some liquidity problems. The current inventory levels might also indicate the business is having some trading problems, (as inventory is not converting into cash quickly).

Receivables collection period

The receivables collection period has more than doubled since the previous year and is 13 days longer than the industry average. The business may be giving customers more credit in order to sell more inventory. Alternatively the receivables collection procedures may need to be tightened up, which would help to improve the business liquidity situation.

Answer- 7**Listed Company**

(a)

(i) Acid Test Ratio

$$= \frac{\text{Current Asset} - \text{Inventories}}{\text{Current Liabilities}}$$

$$= \frac{800,000 - 310,000}{575,000}$$

$$= 0.85 \text{ times}$$

(ii) Debtors Turnover Ratio

$$= \frac{\text{Credit Sales}}{\text{Average Debtors}}$$

$$= \frac{1,675,000}{350,000}$$

$$= 4.79 \text{ times}$$

(iii) Inventory Turnover Ratio

$$= \frac{\text{Cost of Sales}}{\text{Average Inventory}}$$

$$= \frac{1,000,000}{310,000}$$

$$= 3.23 \text{ times}$$

(iv) Asset Turnover Ratio

$$= \frac{\text{Net Sales}}{\text{Capital Employed}}$$

$$= \frac{1,675,000}{950,000 + 725,000}$$

$$= 1 \text{ times}$$

(b) Income Statement as a percentage of sale

	Percentage (%)
Sales	100.00
Less: Cost of Sales	(59.70)
Gross Profit	40.30
Less: Operating Expenses	4.93
Administrative Expenses	13.43
Selling Expenses	(28.36)
Profit before tax	11.94
Less: Taxation	(2.99)
Profit after Tax	8.95

Answer 8:

Rs. in '000'

Ratio	Formula	Waseem	Junaid
Return on capital employed	$\frac{\text{Profit before interest \& tax}}{\text{Avg. capital employed}} \times 100$	$\frac{6,200}{(13,000+2000)} \times 100 = 41.33\%$	$\frac{8,075}{(13,800+1,500)} \times 100 = 52.78\%$
Return on Investment	$\frac{\text{Profit before int. and tax}}{\text{Average total assets}} \times 100$	$\frac{6,200}{16,000} \times 100 = 38.75\%$	$\frac{8,075}{16,500} \times 100 = 48.94\%$
Return on Equity	$\frac{\text{PAT - irredeemable Preference Div.}}{\text{Avg Ordinary Equity}} \times 100$ (Answer is in %)	$\frac{4,700-500}{11,000} \times 100 = 38.18\%$	$\frac{6,875-800}{10,900} \times 100 = 55.73\%$

Average ordinary equity is calculated as below:

Waseem = 6,000 + 1,000 + 4,000 = 11,000

Junaid = 7,000 + 900 + 3,000 = 10,900

Answer- 9

Yee Company

Sales	(W-1)	106,060,606
Cost of Sales	(W-2)	71,060,606
Trade Debtors	(W-3)	35,353,535
Stock in Hand	(W-7)	23,649,369
Trade in Creditors	(W-5)	14,197,121

WORKINGS

(W 1)

$$\begin{aligned} \text{Gross Profit Ratio} &= \frac{\text{Gross Profit} \times 100}{\text{Sales}} \\ 33\% &= \frac{35,000,000 \times 100}{\text{Sales}} \\ \text{Sales} &= \frac{35,000,000 \times 100}{33} \\ &= 106,060,606 \end{aligned}$$

(W-2)

$$\begin{aligned}\text{Cost of Sales} &= \text{Sales} - \text{Gross profit} \\ &= 106,060,606 - 35,000,000 \\ &= 71,060,606\end{aligned}$$

(W-3)

$$\begin{aligned}\text{Debtors Turnover} &= \frac{\text{Credit Sales}}{\text{Trade Debtors}} \\ 3 &= \frac{106,060,606}{\text{Trade Debtors}} \\ \text{Trade Debtors} &= \frac{106,060,606}{3} \\ &= 35,353,535 \text{ approx}\end{aligned}$$

(W-4)

$$\begin{aligned}\text{Stock Turnover} &= \frac{\text{Cost of Sales}}{\text{Average Stock}} \\ 3 &= \frac{71,060,606 \text{ (W-2)}}{\text{Average Stock}} \\ \text{Average Stock} &= \frac{71,060,606}{3} \\ &= 23,686,869\end{aligned}$$

(W-5)

$$\begin{aligned}\text{Creditors Turnover} &= \frac{\text{Credit Purchases}}{\text{Trade Creditors}} \\ 5 &= \frac{70,985,606 \text{ (W-6)}}{\text{Trade Creditors}} \\ \text{Trade Creditors} &= \frac{70,985,606}{5} \\ &= 14,197,121\end{aligned}$$

(W-6)

Inventory A/c			
b/d	23,724,369	COS	71,060,606
Purchases	70,985,606	c/d (W-7)	23,649,369

(W-7)

From W-4 we concluded that

$$\frac{\text{Opening Stock} + \text{Closing Stock}}{2} = 23,686,869$$

Let the opening stock be X then closing stock will be X - 75,000

$$\frac{X + X - 75,000}{2} = 23,686,869$$

$$2X - 75,000 = 23,686,869 \times 2$$

$$2X - 75,000 = 47,373,738$$

$$2X = 47,373,738 + 75,000$$

$$= 47,448,738$$

$$X = \text{Opening Stock} = 23,724,369$$

$$\begin{aligned}\text{Closing Stock} &= 23,724,369 - 75,000 \\ &= 23,649,369\end{aligned}$$

Answer- 10

To: Board of Directors
From: Chief Financial Officer

Date:

Subject: Financial and Operating Performance of Waris Limited

As requested, I have analyzed the financial performance of Waris Limited (WL) with the industry with a view to evaluate the feasibility of launching a takeover bid. My analysis of each category of ratios is as follows:

Profitability Ratios

The gross profit ratio is near to the highest while the operating profit is near to the lowest as compared to similar companies. It indicates that key issue which is affecting WL's profitability is its lack of control over operating expenses. The positive aspect of this situation is that we may be able to improve the profitability just by controlling the operating expenses without being required to make significant changes in the current operations of WL.

Return on shareholders' equity is around the average prevailing in the industry. This ratio is obviously, related to operating profit and as discussed above it can be improved by exercising greater control over operating expenses, after take over.

Working Capital Ratios

WL's working capital ratios specially the current ratio indicates that the company's liquidity position is in line with the industry average. Hence, it seems that the company's working capital is being appropriately managed although there may be some room for improvement.

The inventory turnover is among the lowest in the industry which shows that sound inventory management policies are in place.

However, the level of receivables is among the highest in the industry. The possible causes of the situation may be as follows:

- Poor efforts in making collections
- Lack of proper credit control policies or slackness in their implementation.
- Chances of bad debts which may not have been provided.

We need to seek appropriate explanations and investigate the matters if possible.

Gearing Ratios

The debt equity ratio is on the higher side but can be restructured after acquisition. However, the interest cover is only 1.3. It is among the lowest in the industry and is indicative of a high degree of risk as the profits are barely able to cover the interest charges. Even a slight decline in the profitability of the company may have highly adverse impact on the company's bottom line.

Answer- 11

Rs. in '000'

Ratio	Formula	Edgar	Oswald
Working capital	Current Asset-Current Liabilities	5,000 - 4,300 = Rs. 700	7,300 - 5,300 = Rs. 2,000
Current Ratio	$\frac{\text{Current Asset}}{\text{Current Liabilities}}$	$\frac{5,000}{4,300} = 1.16 \text{ times}$	$\frac{7,300}{5,300} = 1.38 \text{ Times}$
Quick Ratio	$\frac{(\text{Current Assets} - \text{Inventor})}{\text{Current Liabilities}}$	$\frac{5,000 - 2,000}{4,300} = 0.7 \text{ times}$	$\frac{7,300 - 3,600}{5,300} = 0.7 \text{ Times}$
Inventory turnover	$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}} = \text{times}$	$\frac{9,330}{2,000} = 4.7 \text{ times}$	$\frac{15,440}{3,600} = 4.3 \text{ Times}$
Inventory Holding period	$\frac{\text{Inventory}}{\text{Cost of sales}} \times 365$	$\frac{2,000}{9,330} \times 365 = 78 \text{ Days}$	$\frac{3,600}{15,440} \times 365 = 85 \text{ Days}$
Debtor turnover	$\frac{\text{Net Credit Sales}}{\text{Avg Trade Debtors}}$	$\frac{12,000}{2,400} = 5 \text{ times}$	$\frac{20,500}{3,700} = 5.5 \text{ Times}$
Receivable Collection period	$= \frac{\text{Trade receivable}}{\text{credit sales}} \times 365$	$\frac{2,400}{12,000} \times 365 = 73 \text{ Days}$	$= \frac{3,700}{20,500} \times 365 = 66 \text{ Days}$
Creditor turnover	$\frac{\text{Net Credit Purchases}}{\text{Avg. Trade Creditors}} = \text{times}$	$\frac{9,330}{3,700} = 2.52 \text{ Times}$	$\frac{15,440}{3,900} = 3.96 \text{ Times}$
Payable payment period	$\frac{\text{Avg. Trade creditors}}{\text{credit Purchase}} \times 365$	$\frac{3,700}{9,330} \times 365 = 145 \text{ Days}$	$= \frac{3,900}{15,440} \times 365 = 92 \text{ Days}$
Business /Cash Cycle	Inventory days + debtor days - Creditor days	78 + 73 - 145 = 6 days	85 + 66 - 92 = 59 days
Asset turnover	$= \frac{\text{Sales}}{\text{Capital Employed}}$	$\frac{12,000}{(7,100 + 3,000)} = 1.2 \text{ times}$	$\frac{20,500}{(2,800 + 6,700)} = 2.2 \text{ times}$
GP	$\frac{\text{Gross Profit}}{\text{Sales}} \times 100$	$\frac{2,670}{12,000} \times 100 = 22.3\%$	$\frac{5,060}{20,500} \times 100 = 24.7\%$
Operating profit/sales Ratio	$\frac{\text{Operating Profit}}{\text{Sales}} \times 100$	$\frac{(2,670 - 920 - 490)}{12,000} \times 100 = 10.5\%$	$\frac{(5,060 - 2,040 - 1,020)}{20,500} \times 100 = 9.8\%$
Expense ratio	$\frac{\text{Expenses}}{\text{Net sales}} \times 100 = \%$	$\frac{10,740}{12,000} \times 100 = 89.5\%$ (9,330 + 920 + 490) = 10,740	$\frac{18,500}{20,500} \times 100 = 90.2\%$ (15,440 + 2,040 + 1,020) = 18,500

Net profit after tax	$\frac{\text{Profit After Tax}}{\text{Net Sales}} \times 100 = \%$	$\frac{900}{12,000} \times 100 = 7.50\%$	$\frac{1,000}{20,500} \times 100 = 4.88\%$
Net profit before tax	$\frac{\text{Profit Before Tax}}{\text{Net Sales}} \times 100 = \%$	$\frac{1,050}{12,000} \times 100 = 8.75\%$	$\frac{1,400}{20,500} \times 100 = 6.83\%$
Return on investment	$\frac{\text{Profit before int. and tax}}{\text{Avg. total assets}} \times 100$	$\frac{1,050 + 210}{(14,400)} \times 100 = 8.75\%$	$\frac{1,400 + 290 + 10 + 300}{14,800} \times 100 = 13.51\%$
Return on capital employed	$\frac{\text{Profit before interest \& tax}}{\text{Avg. capital employed}} \times 100$	$\frac{1,050 + 210}{(7,100 + 3,000)} \times 100 = 12.5\%$	$\frac{1,400 + 290 + 10 + 300}{(2,800 + 6,700)} \times 100 = 21\%$
Return on Equity	$\frac{\text{PAT} - \text{irredeemable Preference Div}}{\text{Average ordinary Equity}} \times 100$	$\frac{900}{7,100} \times 100 = 12.68\%$	$\frac{1,000}{2,800} \times 100 = 35.71\%$
Gearing ratio	$= \frac{\text{Long term loan}}{(\text{S.C} + \text{S.P} + \text{R.E})}$	$\frac{3,000}{(2,000 + 900 + 3,000)} = 0.51 \text{ times}$	$\frac{6,700}{(2,000 + 0 + 800)} = 2.4 \text{ times}$

Answer-12

(a) Financial ratios

		20X3		20X4	
Return on capital employed	$\frac{\text{Profit before interest and tax}}{\text{Capital employed}} \%$	$\frac{18 \times 100}{(a)105.6}$	= 17%	$\frac{16.5 \times 100}{(b)123.2}$	= 13.4%
Operating profit ratio	$\frac{\text{Profit before interest and tax}}{\text{Sales}} \%$	$\frac{18 \times 100}{180}$	10%	$\frac{16.5}{185.0} \times 100$	= 8.9%
Asset turnover	$\frac{\text{Sales}}{\text{Capital employed}}$	$\frac{180}{(a)105.6}$	1.7 times	$\frac{185}{(b)123.2}$	1.5 times
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	$\frac{13.6}{8.4}$	1.6 : 1	$\frac{11.9}{9.2}$	= 1.3:1

(a) $25 + 45.6 + 15 + 20 = 105.6$

(b) $25 + 48.2 + 15 + 35 = 123.2$

(b) Profitability:

Return on capital employed has fallen from 20X3 to 20X4, caused by a decrease in operating profit and an increase in capital employed. The fall in operating profit may have been caused by an increase in costs, whilst the new investment programme will have caused an increase in capital employed.

Asset turnover has fallen. Sales have only increased by 2.8% between 20X3 and 20X4 so the new investment programme may not yet have had a significant effect upon sales.

In the short term, the investment programme has increased assets and costs but has not yet influenced sales.

Liquidity

The current ratio has deteriorated so the firm's ability to meet its short-term obligations from its short term resources has been reduced. The expenditure on the investment programme may have decreased the cash balance causing the deterioration in liquidity.

Answer-13**Return on capital employed:**

The better return of the Eastown branch suggests it is being well managed as it is earning 37.5% more than the overall average.

Gross profit:

Over 15% lower than the overall average (at 38% compared with 45%), which suggests Eastown is not being managed as well as other branches. However, this could have arisen because the Eastown branch has been competing locally and has had to cut prices and offer incentives to retain and/or expand its customer base. Further information will be needed.

Selling and promotion costs/sales:

The Eastown branch is spending 50% more on promotion. While this could be an indicator of poor management, it is consistent with the suggestion, made above under gross profit, that the branch may have been competing locally (but, of course, promotion costs do not directly impact gross profit). Further information will be needed.

Wages/sales:

Eastown is spending 35.7% more on wages which is another possible indicator of poor management. However, it is also consistent with an attempt to retain and/or expand its customer base through an increased level of service (as a result of employing more staff).

Further information will be needed.

Debtors turnover:

Eastown allows its customers 21% more time to settle their accounts than the average (63 days vs. 52 days) - another possible indicator of poor management. However, it is also consistent with an attempt to retain and/or expand its customer base through an increased level of service (by allowing longer credit terms). Further information will be needed.

Stock turnover:

Turning over stock virtually 25% quicker than the average (37 days vs. 49 days) suggests good management of this aspect of working capital. However, it may be caused by inefficient buying policies that are causing stock shortages and loss of customers. Further information will be needed.

Overall:

The ratios indicate a higher cost and lower profit profile exists at Eastown compared with the average. This may indicate poorer management, or may be due to the environment in which the branch is operating or it may, for example, be in competition with a price-cutting competitor. Control over debtors appears weak, but may be due to a need to compete. The only positive ratio result is the lower stock turnover period. However, it could actually be an indication that mismanagement is occurring.

The ratios in themselves are insufficient to draw any firm conclusions regarding the quality of management of the branch. However, they do indicate questions that should be asked and points that should be raised if an objective view on the quality of the branch's management is to be reached.

ICAP PAST PAPER QUESTIONS**Question-1**

The following information pertains to Shale Distributors Limited (SDL):

Sales
Purchases
Cost of goods sold
Trade receivables
Trade payables
Inventories

All the purchases and sales are on credit.

Required:

(a) Calculate the cash operating cycle of SDL and explain briefly its significance.

(04)

(Assume a 360-day year)

(b) Describe any two limitations of accounting ratios.

(02)

{Autumn 2011, Q.6}

QUESTION-2

Following amounts have been determined from the records of Hassan Limited.

Description	2014	2015	2016
	-----Rs. in million-----		
Sales	100.00	120.00	135.00
Cost of sales	75.00	90.00	101.25
Profit before interest and tax	6.00	5.50	5.60
Account receivable	16.50	25.00	35.00
Account payable	13.00	13.00	15.00
Inventory	18.75	26.00	30.40
Cash at bank/(overdraft)	5.00	(0.50)	(2.00)

Required:

Calculate liquidity ratios and working capital cycle for 2015 and 2016 and comment on the results of your calculation, assuming that all sales and purchases are made on credit.

(10)

{Autumn 2016, Q.7}

Question-3

Ali and Bashir are chartered accountants and have been working as Managing Director (MD) and Chief Financial Officer (CFO) in a listed company. In a recent meeting of the Board, the directors have decided to expand the business within six months by opening 20 retail outlets. This expansion would require financing of Rs. 300 million which may be arranged through bank loan.

The following information has been extracted from latest draft financial statements of the company:

	Rs. in '000'
Sales	1,700
Gross profit	545
Tax expense	23
Profit after tax	40
Total assets	2,500
Non-current assets	900
Inventories	850
Trade receivables	600
Share capital	800
Reserves	152
Long term debt @ 9%	750

Following additional information is also available:

- 80% of the sales are on credit.
- Opening inventory was Rs. 100,000.
- 40% of current liabilities comprise of trade payables.

Required:

Compute liquidity, debt and working capital ratios of the company.

(06)
{Spring 2016, Q.3}

QUESTION-4

- (a) The following information has been gathered by an analyst, in respect of Dairy Foods Limited (DFL) which specializes in various dairy products.

Ratio	2016	2015	2014	Industry average
Profit margin %	11%	10%	8%	10.45%
Quick ratio	1.38	1.40	1.42	1.52
Current ratio	1.84	1.67	1.59	1.73
Days purchases in payables	80	91	89	82

In the latest annual report to the shareholders, Directors of DFL have claimed that liquidity position of the Company has improved significantly.

Required:

Critically analyze and discuss whether you agree with the claim.

(03)

- (b) Extracts from latest financial statements of two companies are as follows:

Extracts from statements of financial position

Equity and liabilities	A	B	Assets	A	B
	Rs. in million			Rs. in million	
Equity and reserves	51,690	72,114	Fixed assets	34,460	48,076
Long term loan	-	36,057	Stock in trade	21,700	20,000
Trade creditors	35,790	45,135	Trade debtors	24,470	44,030
Other payables	12,000	8,500	Cash and bank	18,850	49,700
	99,480	161,806		99,480	161,806

Extracts from statements of comprehensive income

	A	B
	Rs. in million	
Revenue	161,600	220,150
Cost of sales	(135,160)	(180,520)
Gross profit	26,440	39,630
Operating expenses	(9,840)	(13,870)
Interest expense	(720)	(2,313)
Profit before tax	15,880	23,447
Income tax	(333)	(409)
Profit after tax	15,547	23,038

Required:

Analyze the profitability, liquidity and working capital ratios of both the companies.

(12)

Question-5

Progressive Steel Limited (PSL) commenced business in 2015. The following comparative data pertains to the year ended 30 June 2017:

Description	PSL		Industry
	2017	2016	2017
Gross profit margin	13%	13%	16%
Net profit margin	8%	7%	10%
Return on shareholders' equity	22%	18%	25%
Current ratio	1.2	1.6	1.5
Debt to equity ratio	40:60	30:70	50:50
Cash operating cycle in days	119	135	118

Required:

For each ratio/data give possible reasons for variation from comparative and industry data.

(12)

Question-6

Boom Limited (BL) is a manufacturer of sports goods. Following financial statements for the year ended 31 December 2017 have been submitted to the Chief Executive Officer (CEO).

Statement of profit or loss

	Rs. in '000'
Revenues	21,000
Cost of sales	(17,500)
Gross profit	3,500
Operating expenses	(1,000)
Finance cost	(450)
Profit before tax	1,150
Taxation	(345)
Profit after tax	805

Statement of financial position

	Rs. in '000'
Property, plant and equipment	7,500
Current assets	1,500
	9,000
Share capital	4,000
Reserves	1,000
Non-current liabilities	3,000
Current liabilities	1,000
	9,000

Although performance of BL has improved from the last year, CEO wants to compare the results with other companies operating in sports manufacturing industry. In this respect, following industry data has been gathered:

Gross profit margin	23.5%
Net profit margin	5.7%
Current ratio	2.5
Gearing ratio	50:50
Return on non-current asset	12.0%
Return on capital employed	25.4%
Return on equity	31.3%